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Supreme Court, U.S.
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No. _____

In The
Supreme Court of the United States

THE THOMAS KINKADE COMPANY, LLC
and RICHARD F. BARNETT,

Petitioners,

v.

KAREN HAZLEWOOD, JEFF SPINELLO
and THOMAS KINKADE AT
THE DOWNTOWN MALL, LLC,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The United States Court of Appeals for the Ninth Circuit summarily reversed two decisions of the United States District Court for the Northern District of California which had vacated a two-part award ("Final Award") entered in the arbitration ("Arbitration") between Petitioners and Respondents (together, "Parties") – the first part finding for Respondents on the merits ("Merits Award") and the second part awarding Respondents attorneys' fees ("Fee Award") – and reinstated that Final Award. The District Court had vacated the Merits Award based on facts and findings that it deprived Petitioners of the benefits of the Parties' agreed-upon rules for conducting the Arbitration and that the panel majority exceeded its authority and denied Petitioners a fair arbitration. The District Court vacated the Fee Award because the underlying Merits Award was vacated. In addition, although the District Court did not rely on this, discovery before the District Court showed that Respondents' counsel engaged in fraud, spoliation of evidence and perjury, most of which the arbitration panel ("Panel") never knew about.

The Ninth Circuit's decision, unless reversed by this Court, will discourage parties from pursuing arbitration and undermine their confidence that courts will effectively review arbitration awards as Section 10(a) of the Federal Arbitration Act ("FAA") requires. 9 U.S.C. §10(a). Further, by exercising jurisdiction even though the District Court had ordered arbitration panel reconsideration, the Ninth

QUESTIONS PRESENTED – Continued

Circuit acted contrary to the holdings of other Circuits, and, indeed, earlier Ninth Circuit panels. The questions presented are:

1. Whether the Ninth Circuit, by depriving Petitioners of the Parties' agreed-upon rules for conducting the Arbitration, decided an important federal question in a way that conflicts with this Court's mandate in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Univ.* ("*Volt*"), 489 U.S. 468 (1989), and other authority.

2. Whether the Ninth Circuit so far departed from the accepted course of judicial proceedings as to call for an exercise of this Court's supervisory powers by reinstating the Final Award that the District Court had found was tainted by sanctionable conduct and fraud and issued by a Panel that exceeded its authority and denied Petitioners a fair arbitration.

3. Whether by exercising jurisdiction over this appeal, even after the District Court had granted Respondents' motion for rehearing and ordered certain issues submitted to a new arbitration panel for reconsideration, the Ninth Circuit acted in conflict with the decision by the United States Court of Appeals for the Third Circuit in *Virgin Islands Housing Auth. v. Gen. Coastal Constr. Servs. Corp.*, 27 F.3d 911 (1994) ("*Virgin Islands*") as to an important federal question that has not been decided but should be settled.

LIST OF PARTIES AND RULE 29.6 STATEMENT

The caption contains the names of all parties to the proceeding in this Court whose judgment is sought to be reviewed.

Pursuant to Rule 29.6 of the Rules of this Court, Petitioners state that the Thomas Kinkade Company, LLC ("TKC"), formerly known as the Thomas Kinkade Company, formerly known as Media Arts Group, Inc., is a privately-held California limited liability company. It has no parent corporation and no publicly-held company owns 10 percent or more of it.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners TKC and Richard F. Barnett ("Barnett") respectfully petition for a writ of certiorari to review the following orders of the Ninth Circuit: (1) reinstating the Final Award and reversing the District Court's granting of Petitioners' application to vacate the Final Award in light of Section 10(a) of the FAA, 9 U.S.C. §10(a), and (2) denying Petitioners' Petition for Panel Rehearing With Suggestion for Rehearing *En Banc* ("Petitioners' Rehearing Petition").

OPINIONS BELOW

The Memorandum Opinion of the Ninth Circuit (App.1-5) was not issued for publication or use as precedent but is reported by Westlaw at 2009 WL 1974454. The Order denying Petitioners' Rehearing Petition (App.175-76) is unreported. The District Court's orders are not officially reported but are reported by Westlaw. The District Court's June 6, 2007 Order vacating the Merits Award is at 2007 WL 1655846. The District Court's July 18, 2007 Order vacating the Fee Award is at 2007 WL 2402149. The District Court's August 29, 2007 Order granting partial rehearing is at 2007 WL 2088584.

JURISDICTION

The Ninth Circuit entered its Order reversing the District Court and reinstating the Final Award on

June 16, 2009. Petitioners timely filed their Rehearing Petition on July 1, 2009. The Ninth Circuit denied Petitioners' Rehearing Petition on July 24, 2009. This Court has jurisdiction pursuant to 28 U.S.C. §1254.

STATUTORY PROVISIONS INVOLVED

1. FAA §10(a), 9 U.S.C. §10(a) (App.177).
2. Cal. Civil Code §1668 (App.178-79).
3. Cal. Code Civ. Proc. §1283.8 (App.179).

STATEMENT OF THE CASE

A. Facts Material To The Questions Presented

1. The Parties Agreed To Specified Rules For Their Arbitration

Petitioner TKC manufactures, markets, distributes and licenses reproductions of artwork based on the paintings of Thomas Kinkade ("Kinkade"). Petitioner Barnett is TKC's Senior Vice-President. He helped manage the "Signature Gallery Program," which was TKC's primary channel for distributing artwork.

The individual Respondents ("Hazlewoods") reside in Virginia and owned and operated Respondent Thomas Kinkade at the Downtown Mall, LLC, a

Virginia limited liability company. (LD1 ¶22 & Ex. 40 ¶¶56, 62).[1]

Pursuant to the Signature Gallery Program, TKC entered into two "Signature Gallery Dealer Agreements" ("Dealer Agreement(s)") with the Hazlewoods in January 1999 and March 2000, respectively. The Hazlewoods opened one gallery in Charlottesville, Virginia in March 1999 and a second in Fredericksburg, Virginia in December 2000 pursuant to these respective Dealer Agreements. Both galleries failed and closed in 2003. (LD1 ¶¶23, 36).

Each Dealer Agreement contained identical arbitration clauses. The Agreements provided that, absent informal resolution of a dispute:

> **ANY REMAINING DISPUTE SHALL BE SUBMITTED TO A PANEL OF THREE (3) ARBITRATORS WITH EACH PARTY CHOOSING ONE (1) PANEL MEMBER, AND THE THIRD PANEL MEMBER BEING CHOSEN BY THE FIRST TWO (2) PANEL MEMBERS.** *THE PROCEEDINGS SHALL BE CONDUCTED IN ACCORDANCE WITH THE COMMERCIAL ARBITRATION RULES OF THE AMERICAN ARBITRATION*

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[1] As part of Appellees' Designated Record before the Ninth Circuit submitted on March 10, 2008 (9th Cir. Docket No. 16), Petitioners submitted the Declaration of Dana N. Levitt in support of the Motion to Vacate Arbitration Award ("LD1") and the Declaration of Dana N. Levitt in support of the Motion to Vacate the Attorney's Fee Award ("LD2").

> *ASSOCIATION*. **THE AWARD OF THE ARBITRATORS SHALL INCLUDE A WRITTEN EXPLANATION OF THEIR DECISION. THIS ARBITRATION PROCEEDING WILL BE BINDING UPON THE PARTIES.**

(LD1 ¶33, Exs. 42 (¶22); 43 (¶22). (Bold-faced emphasis in original; italicized emphasis added).

The Dealer Agreements expressly excluded consequential or lost profit damages from any arbitration award, stating:

> **IN NO EVENT SHALL EITHER PARTY BE LIABLE HEREUNDER FOR ANY INDIRECT, INCIDENTAL OR CONSEQUENTIAL DAMAGES (INCLUDING LOST BUSINESS PROFITS) SUSTAINED BY THE OTHER PARTY OR ANY OTHER INDIVIDUAL OR ENTITY FOR ANY MATTER ARISING OUT OF, ABOUT, OR PERTAINING TO THE SUBJECT MATTER OF THIS AGREEMENT.**

(LD1 ¶31 & Exs. 42-43). The Dealer Agreements provided that California law would govern. (LD1 Ex. 38).

The parties agreed with the Panel that the Arbitration would be formal and framed by pleadings and that each side would have a proper opportunity to conduct discovery.

2. The Panel Majority Allows Respondents To Pursue A Fraudulent Concealment Claim Based Solely On A Rejected Pleading As To Which Petitioners Had No Discovery

The Hazlewoods initiated the Arbitration with the American Arbitration Association ("AAA") on September 26, 2003 against TKC and 19[2] individual respondents.[3] The claim alleged 12 claims, including fraudulent concealment. Respondents asserted that Petitioners had fraudulently concealed that: (1) the Dealer Agreements were franchise agreements; (2) the Hazlewoods would be subject to TKC's Retail Sales Policy; and (3) Barnett and other TKC employers were paid commissions on sales of art to Signature Dealers. The Hazlewoods filed a First Amended Claim ("FAC") on January 2, 2004, adding their limited liability company as a claimant but otherwise repeated earlier allegations as to fraudulent concealment against Petitioners. (LD1 ¶¶37-38, 44).

Each side appointed a non-neutral arbitrator to the Panel. Respondents appointed Michigan attorney

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[2] These included Kinkade and 18 TKC individual officers and directors. On May 6, 2004, the Panel granted portions of TKC's motion to dismiss, dismissing 18 individual respondents (including Kinkade) (LD1 ¶54).

[3] Those who were "respondents" (small "r") in the Arbitration are Petitioners here. Likewise, Respondents here were "petitioners" (small "p") in the Arbitration.

Mayer Morganroth, who had also been selected as the non-neutral arbitrator in another arbitration against TKC involving another Signature Dealer Agreement (the "White Arbitration"). Petitioners appointed Richard Chernick. Chernick is a former partner of the Los Angeles office of Gibson Dunn, past president of the Los Angeles County Bar Association, founder of the College of Commercial Arbitrators and author of the RUTTER GUIDE ON ARBITRATION. Morganroth and Chernick named James Grossman as the neutral arbitrator. (LD1 ¶40).

Morganroth and Grossman became close friends. Grossman drove Morganroth to the Arbitration each morning and they almost always ate lunch together. Grossman's later behavior suggests improper influence by Morganroth. (LD1 ¶43).

The Arbitration hearings began in December 2004. On April 6, 2005 – five months later and after the Hazlewoods had been deposed and extensive discovery had been completed – Respondents sought leave to file a Second Amended Complaint ("SAC") to present new facts that allegedly were concealed from them. (LD1 ¶113). The Panel denied Respondents' motion on April 18, 2005. The FAC remained the operative pleading throughout the Arbitration. (LD1 ¶¶114, 120).

The parties simultaneously filed closing briefs with the Panel on November 12, 2005. Respondents' closing brief concentrated almost exclusively on facts and a legal theory of fraudulent concealment found

only in the rejected SAC. Accordingly, in their reply closing brief, Petitioners reaffirmed that the SAC was not at issue, that Petitioners rightly directed their discovery and presentation of their case solely to the FAC's allegations and that the Panel could not base any ruling on the SAC. (LD1 ¶¶122-24). At closing argument on December 5, 2005, after Respondents' counsel referenced matters outside the FAC, Grossman agreed with Chernick on record that the FAC "is what's before us." (LD1 ¶125).

After closing arguments and because of Respondents' reliance on the SAC, Petitioners made four offers of proof to the Panel and requested additional hearing days to present evidence to refute false allegations in the SAC. (LD1 ¶¶126-27). The Panel denied the additional hearing dates, and the majority rejected each offer of proof. (LD1 ¶127).

3. The Panel Majority's Misconduct Denied Petitioners A Fair Arbitration

The undisputed facts, as found by the District Court, confirm that Petitioners were denied a fair arbitration because of misconduct by Morganroth, Grossman and Respondents' Attorneys. (App.5-52).

(a) Respondents' Non-Neutral Arbitrator Failed To Disclose His Financial Interest In The Arbitration Outcome And Otherwise Acted In Bad Faith

Respondents were impecunious and could not afford to pay Morganroth. Respondents owed him at least $226,400 at the close of evidence. (LD1 ¶42). Morganroth at all times understood that his compensation depended upon Respondents winning a large arbitration award. Because his personal remuneration turned on a favorable outcome for Respondents, Morganroth was hired on a *de facto* contingency fee basis, yet never disclosed this. This nondisclosure violated Canon X of the AAA Code of Ethics for Arbitrators in Commercial Disputes ("Canon X"), which requires an arbitrator to disclose a financial interest in an arbitration's outcome. (App.12).

Morganroth engaged in other conduct that violated Canon X's ethical obligation to "act in good faith and with integrity and fairness." He: (1) falsely accused Petitioners' counsel of criminal conduct; (2) interjected false assertions about the White Arbitration, including misrepresenting that the White Arbitration panel had found TKC and its counsel liable for discovery abuses; (3) was rude and obstructive toward Petitioners' counsel, including falsely suggesting that counsel suborned perjury;[4] and (4) was

[4] As shown below, Respondents' counsel *did* both suborn the perjury of others and commit perjury himself in the Arbitration, yet was rewarded for this.

abusive toward Petitioners' witnesses. Petitioners believe Morganroth's inappropriate behavior was motivated at least in part by his desire to see Respondents win a large enough award to at least cover his fee. (LD1 ¶¶89-109).

(b) The Purported "Neutral" Arbitrator Displayed Bias Favoring Respondents

Grossman, allegedly the "neutral" arbitrator, instead was biased in favor of Respondents. First, even though the parties agreed on the third day of hearings to divide the next 10 days evenly, when Respondents' counsel could not honor this agreed-upon limit, Grossman overrode the parties' agreement and gave Respondents' counsel more time. (LD1 ¶¶79-84). This improperly advantaged Respondents and denied Petitioners – who had shaped their trial presentation around these time limits – the benefits of their efficiency. When Petitioners' counsel complained that this broke the parties' agreement, Grossman responded "[i]n your mind." (LD1 ¶80). Second, when Petitioners sought discovery as to Morganroth's fee arrangement, including whether Respondents had paid him anything, Grossman denied such discovery, leaving Petitioners unable to verify fully Morganroth's ethical violations. (LD1 ¶86). Third, Grossman unequivocably showed bias when, at the close of hearing on Respondents' attorneys' fees, he hugged and kissed Ms. Hazlewood. (LD1 ¶12).

(c) Respondents' Counsel Engaged In Sanctionable Conduct During The Arbitration Hearings With Impunity

It is undisputed that Respondents' counsel – the Yatooma Firm – engaged in substantial misconduct during the Arbitration. The Panel found that the Yatooma Firm's sanctionable behavior, included: (1) repeated *ex parte* contact with an adverse party who was represented by Petitioners' counsel; (2) theft of a privileged email from TKC's headquarters during an inspection; (3) improper threats of criminal prosecution against Kinkade during his deposition; and (4) abusive tactics and language toward Petitioners' counsel. Despite these findings, the Panel imposed no ascertainable penalty on the Yatooma Firm. (LD1 ¶¶57-64).

Additionally, beginning in 2005 and through January 2006, the Yatooma Firm secretly but regularly relied upon a former TKC employee, Terry Sheppard, to surreptitiously monitor the White Arbitration and transmit questions to Respondents' lawyers via computer connection for use in questioning Petitioners' witnesses in this Arbitration. (LD1 ¶¶70-72). When Sheppard testified in this Arbitration, he falsely denied that he was receiving payment in the White Arbitration, even though he was White's paid consultant. (LD1 ¶68). Respondents did not attempt to correct his lie. Petitioners discovered Sheppard's

misconduct in January 2006, when a court reporter in the White Arbitration disclosed the surreptitious monitoring. (LD1 ¶¶69-70).

4. The Panel Issues An Interim Award In Favor Of Respondents

The Panel Majority issued its Interim Award on February 23, 2006, finding that Petitioners were liable to Respondents for fraud in the amount of $860,000.[5] Respondents were then allowed to apply for attorneys' fees, costs, expenses and interest (the "Fee Application"). Respondents sought compensation for Morganroth. When Petitioners sought discovery regarding this, Grossman refused, stating "[t]he chair has no reason to believe that either Mr. Morganroth or Mr. Chernick has any contingency fee in this matter." (LD1 ¶86). Therefore Grossman allowed Morganroth (the interested party) to vote in favor of his own fee and ordered Respondents to pay Morganroth $200,000. (*Id.*).

The parties engaged in additional discovery, briefing, and hearings as to the Fee Application. (LD1 ¶139).

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[5] The Panel also found Petitioners liable for breach of the covenant of good faith and fair dealing and interference with advantageous business relationships but found that these caused Respondents no additional damage. The Panel dismissed the remaining claims and denied TKC's counterclaim.

5. The Final Award Is Untimely

On September 5, 2006, Grossman requested and the parties agreed to an October 6, 2006 deadline for the issuance of the Final Award. Despite this agreement, the Panel transmitted the Final Award to the parties on October 10, 2006, four days after the deadline. Under California law, in order to be "made" timely, the Final Award must be issued to the parties. The AAA requires a Panel to send the signed award to it and it thereafter transmits the award to the parties. Grossman did not send even the AAA his signature to the Final Award until October 7, 2006 – one day after the deadline. (LD1 ¶9).

6. The Panel Finds Fraud Based On The SAC

The Merits Award found Petitioners liable for fraud based on: (1) Petitioners allegedly "painted an unrealistic and misleading picture of the prospects of success for a dealer;" (2) Barnett allegedly failed to disclose his "special relationship" with Kinkade and resulting "lucrative advantages;" (3) Petitioners allegedly failed to disclose the "inherent risk involved in becoming an art gallery owner;" and (4) Petitioners allegedly failed to advise Respondents of relevant changes in financial conditions regarding corporate stores and other Signature Gallery dealers, which impacted the information they initially provided to Respondents. (App.16). Yet these allegations were

pleaded only in the SAC. Petitioners were allowed no discovery as to these allegations.

In dissent, Chernick objected:

> The parties and the Panel also consistently treated the pleadings as determinative of the Tribunal's power. * * *
>
> The Majority should have treated this issue of the proposed Second Amended Claim in the same fashion. Instead, it relied on evidence that was not the subject of the Claims Notification Process; not disclosed by a pleading that was permitted to be filed in this case; and that was never tested by discovery. Respondents were unable to offer opposing evidence during the hearing and were not permitted to reopen to offer such evidence when it was later discovered after the close of the hearing.

(App.37-38).

7. The Panel Awards Respondents Consequential And Lost Profit Damages Despite The Parties' Agreement Excluding These

The Panel Majority determined that any damage limitations contained in the Dealer Agreements were void in light of their finding of fraud-in-the-inducement. (App.16). As to Sheppard, the Panel Majority stated that it "gave little if any weight to Sheppard or his testimony," ignoring the prejudicial impact the

Yatooma-Sheppard scheme may have had in this Arbitration. (App.17).

The Panel Majority awarded Respondents less than they requested, finding that Respondents' damages expert had credibility problems that required a "significant discount" from the numbers he had submitted. The Panel's final damage award was $860,100, composed of $122,500 in "out of pocket expenses" and $737,600 in "loss of income" and "the value of the possible sale of the business" – these latter damages being, essentially, forms of consequential damages and lost profits. (App.17).

8. Respondents' Attorneys Falsified Billing Records And Engaged In Fraud, Spoliation And Perjury In Seeking Fees

After the Panel determined that Respondents prevailed, it directed Respondents to file their Fee Application. Respondents' Fee Application sought more than $2.5 million in fees and costs. Petitioners' counsel became suspicious of Respondents' asserted fees when he learned that the Fee Application claimed $1.3 million in fees had been incurred through April 21, 2005, when Ms. Hazlewood had testified on that date that Respondents had, instead, incurred only $818,000 in fees through that date. (LD1 ¶135). Although the Fee Application included bills and cost records, there were no declarations affirming their accuracy or authenticity. (LD1 ¶134).

Petitioners then sought discovery regarding the Fee Application, including the production of fee agreements, contemporaneous timesheets and depositions, including of Norman Yatooma ("Yatooma"), the Firm's principal attorney. (LD1 ¶138). While this request was pending, the Panel ordered Respondents to produce all documents pertaining to their fee arrangement with their attorneys, together with an affidavit under penalty of perjury confirming that these documents constituted all binding agreements they had with counsel. (LD1 ¶140). In response, Respondents produced two fee agreements indicating, first, that Respondents agreed to pay a flat, hourly rate of up to $425, and second, that all services performed after December 14, 2004 were billed on a pure contingency basis. (LD1 ¶141).

Respondents opposed Petitioners' discovery request, claiming that producing the requested timesheets would be unreasonably burdensome. (LD1 ¶145). Nonetheless, the Panel granted Petitioners' discovery request. (LD1 ¶146). The following day, Respondents sought reconsideration of the Order to produce contemporaneous timesheets. The Panel denied reconsideration. Faced with this Order, and after previously arguing how burdensome production would be – Respondents' Attorneys completely reversed themselves and denied that the Firm had contemporaneous timesheets. (LD1 ¶149). The Yatooma Firm initially produced fewer than 50 pages of documents, and produced 279 additional pages before one of the depositions ordered by the Panel.

These included time entries that suggested Joe Ejbeh ("Ejbeh"), Respondents' lead attorney in the Arbitration, whom the Yatooma Firm later fired, had purportedly billed 20 successive 20-hour days, including weekends. (App.86-87).

Petitioners then deposed Yatooma. He testified that all contemporaneous timesheets were routinely deleted from his Firm's computer and that no written time record existed for Respondents' Attorneys in the Arbitration except what was attached to the Fee Application. (LD2 ¶62). He testified that the bills attached to the Fee Application were copies of what had been sent to Respondents and were not "recreated after the fact." (*Id.*). Sarah Smigels ("Smigels"), the Yatooma Firm's office manager, testified that after she received time submissions, she entered them into a computer time-recording program and deleted the emails. (LD2 ¶60). The Panel accepted these assertions in issuing the Fee Award. (LD2 ¶76).

Petitioners argued to the Panel that the Fee Application was grossly inflated and included false time entries and that Respondents' Attorneys were trying to collect from Petitioners all fees for work they had done for many clients on a joint basis. (LD2 ¶64). The Panel Majority agreed that they had "serious reservations about the validity of the Fee Application" and that many time entries were "obviously unsupportable." (LD2 ¶78). They agreed that 20 successive 20-hour days was "a feat that the entire panel believes is not possible if proper time records were being maintained." (App.133). The Panel

acknowledged that a flat rate of $425 was inflated and included hours billed by junior associates whose customary rates were below $200. (App.133). Despite lacking "reliable" evidentiary support for Respondents' Fee Application, the Panel purported to make its own determination of a "reasonable fee" based on the scope of the representation, counsel's effort, the appropriate hourly rates for counsel and staff and other factors, including the discussion of sanctions, and awarded $900,000 in fees. (App.134-35). This award was nearly $40,000 larger than the damages awarded to Respondents.

In dissent, Chernick wrote:

> But simply estimating a reasonable time and effort and a reasonable rate to arrive at a "reasonable" fee in these circumstances rewards dishonesty and ignores a manifest failure of proof.
>
> The proper remedy when knowingly false support is offered for a claim for reimbursement is to deny the reimbursement entirely rather than to try, as the majority did, to figure out what was reasonable in the circumstances (*i.e.*, what the Firm would have submitted if it had kept honest records). This sanctions a fraud on the panel and is wholly inappropriate.

(App.169-70).

Besides awarding Respondents damages and fees, the Final Award required Petitioners to pay

$200,000 of Morganroth's compensation. It further required Petitioners to pay administrative fees, witness fees and the neutral arbitrator's compensation. (LD2 ¶2).

Petitioners then applied on November 13, 2006 to the District Court to vacate the Final Award. (LD1, Cover). On January 8, 2007, Petitioners moved for limited discovery regarding the Fee Application. The District Court granted this, and Petitioners conducted discovery thereafter. This revealed extensive fraud, spoliation of evidence and perjury that the Panel was unaware of (even though it knew of other acts of fraud).

(a) Respondents' Attorneys Submitted False Bills

Discovery in the District Court revealed that the bills submitted with the Fee Application were different from those actually sent to Respondents. Petitioners' Counsel submitted declarations and attached a set of "genuine" bills taken from the Yatooma Firm client file whose time entries were consistent with the contemporaneous time records. (LD2 ¶¶2-4). However, these entries were inconsistent with the bills Respondents' Attorneys submitted with the Fee Application. (LD2 ¶4).

Comparing the bills attached to the Fee Application with the "genuine" bills produced in District Court discovery revealed numerous entries which are identical in terms of date, description, and billing

attorney but contain large discrepancies between the hours allocated. For example, the first entry in the genuine bills was for 1.25 hours of work by Ejbeh described as "Reviewed documents produced by Media Arts in preparation for depositions of Media Arts' witnesses." The Fee Application bills contain an identical entry but inflate the hour figure from 1.25 to 13.75 hours, a 12½-hour discrepancy. Reviewing the first page of each set of bills showed that six of the eight entries are multiplied by a factor of 7, 9, 11 or 15. (LD2 ¶85). Besides misrepresenting the hours spent, Yatooma improperly requested $425/hour in the Fee Application when Firm attorneys actually charged a lower rate. (LD2 ¶59).

Respondents' Attorneys responded that the Fee Application sought fees billed to multiple clients but that what was produced in discovery reflected only what was allocated to this Arbitration. (App.60-61). They did not explain why they had sought from Petitioners fees owed by other clients in the first place.

Respondents' Attorneys had previously misrepresented this fact to the Panel. In their Fee Application, the Yatooma Firm told the Panel "[Respondents] became liable to pay for each service and for each cost." (LD1, Ex. 109 p.6768). Yatooma further testified in Arbitration that the bills submitted with the Fee Application "accurately set forth the amount of costs and attorney fees *incurred by [Respondent] in the prosecution of this case.*" (LD1, Ex. 34 at 8266:4-16 (emphasis added)). Yatooma previously testified to

the contrary. (LD1, Ex. 34 at 8242:5-20). Additionally, Yatooma falsely denied before the Panel the existence of "any agreement applied between the [Respondents] here and the claimants in any other case against Media Arts to share any costs or expenses of litigation." (LD1, Ex. 34 at 8240:12-16). Finally, both Yatooma and Smigels falsely testified that the bills attached to the Fee Application accurately reflected the charges incurred only for this Arbitration – not Media Arts matters in general – when, in fact, Respondents' Attorneys sought to saddle Petitioners with bills owed by other clients. (LD1 Ex. 109 at Exs. 11 ¶21 & 12 ¶4).

Yatooma also lied in his deposition in the Arbitration in testifying that "the bills were not recreated" after the fact, and that "the bills that you have are what's on the system." (LD1, Ex. 89 at 16:20-17:7).

(b) Ejbeh Confirms Fraud In The Fee Application

In deposition, Ejbeh testified regarding his concerns about the Fee Application and the time attributed to him. He testified that he had seen a note at the Yatooma Firm detailing the billing protocol for Media Arts matters, stating that 100 percent of Media Arts time should be allocated to Hazlewood, 50 percent to the White Arbitration and 50 percent to the remaining clients. Ejbeh told Yatooma that the allocation was "not right." Yatooma responded that he was not planning on collecting fees multiple times,

but was "front-loading them on Hazlewood" to prevent "Media Arts and all the racketeers and the crooks that they are" from benefiting from the fact that attorney work product was being shared by multiple clients. (LD2 ¶81).

The Yatooma Firm then sent Ejbeh an affidavit to sign to attest to the purported accuracy of the time attributed to him in the Fee Application. (LD2 ¶81). Ejbeh refused. On June 20, 2006, Ejbeh emailed the Yatooma Firm that the difference between his actual billing records and the time submitted to the Panel "is night and day." (LD2, Ex. 17). In deposition, Ejbeh testified that the time entries attributed to him "appeared to be inaccurate from the standpoint that time entries that were Media Arts general had been upgraded to higher amounts." (LD2, Ex. 2 at 95:10-16).[6]

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[6] After the Yatooma Firm fired Ejbeh, he was replaced by Edward W. Fisher as Respondents' lead counsel. On July 3, 2008, while this matter was before the Ninth Circuit, Fisher was convicted in the United States District Court for the Eastern District of Michigan of conspiracy to defraud the U.S. Treasury of $51 million and is now in prison. The Ninth Circuit was advised of this. *See* letter from D. Levitt to the Ninth Circuit dated July 10, 2008. (9th Cir. Docket No. 20).

(c) Respondents' Attorneys Intentionally Destroyed Evidence To Conceal Their Fraud

To try to conceal the plan to bill Petitioners for unrelated matters, Yatooma ordered his staff to destroy evidence showing that the Firm had solely billed Petitioners for matters that were really related to Media Arts clients in other arbitrations. (LD2 ¶75). Petitioners noted an email from Yatooma to his staff where he answered the question, "When I am copying receipts – should I try to take off other case names (White, Wittman, etc.)?" with "Yes, remove other case names." (LD2 ¶71, Ex. 3, pp.972-96). Additionally, Firm employees altered certain descriptions or time entries to remove references to other Media Arts cases. Ejbeh's timesheets from March 30-31, 2005, for example, contain the entry "Attendance at trial testimony of Terry Sheppard **to be used in all MDA cases**." (Emphasis added). The Fee Application bills, however, omit the emphasized portion of that entry. (App.71).

(d) Yatooma Firm Representatives Lied In Claiming They Lacked Contemporaneous Timesheets

In depositions taken while the District Court oversaw the matter, witnesses admitted that the Yatooma Firm, contrary to representations in its Fee Application, *did* use and maintain contemporaneous timesheets, but lied to the Panel. (LD2 ¶¶80-81). After Petitioners deposed former Yatooma Firm

employees who confirmed this, the Firm produced hundreds of contemporaneous timesheets, totaling more than 2,000 pages. (LD2 ¶84). Even these pages, however, represented only a fraction of bills that existed before the Yatooma Firm systematically deleted time entries.

Other witnesses confirmed that Smigels and Yatooma lied in claiming that there were no contemporaneous time records. (LD2 ¶¶80-81). Yatooma Firm employees testified that Excel spreadsheets existed which contained contemporaneous time recordings. (LD2 ¶80). Ejbeh testified that he was able to retrieve all of his 2005 timesheets from the Yatooma Firm's computer systems in Fall 2005. Ejbeh also testified that Yatooma gave him a large stack of Yatooma's own timesheets in November 2005, showing that Yatooma knew that such billing records existed. (LD2 ¶81, Ex. 12 at 106-10). While Respondents challenged these witnesses' credibility, they could not and did not deny the accuracy and authenticity of the timesheets that they themselves later produced.

(e) Respondents' Attorneys Sought Fees From Petitioners That Other Clients Already Had Paid

In discovery before the District Court, Respondents produced bills sent to other clients for work performed in October through December 2004 which had been listed on the Fee Application bills as owed

solely by Petitioners. (LD2 ¶¶14, 21, Exs. 7, 16, 26). The production included checks showing that other clients already had paid these bills. Respondents did not deny that they sought from Petitioners fees and expenses that others had already paid, but asserted that they fully disclosed the duplicate billing to the Panel, along with their purported intent to credit those clients if they recovered such paid fees a second time from Petitioners. (LD2, Exs. 22 & 24). No evidence, however, supports Respondents' assertion.

9. The District Court Vacates The Final Award

The District Court presided over the appeal from the Arbitration for more than 10 months. It allowed the parties to conduct discovery and conducted several evidentiary hearings regarding the Arbitration's fairness and the Panel's exercise of its authority.

On June 6, 2007, the District Court vacated the Merits Award. (App.5-52). The Court found that the Panel violated the FAA and had exceeded its authority. (App.53-95). First, the Panel awarded lost profits and consequential damages despite the parties' agreement to exclude such damages, an agreement which the District Court held was enforceable. (App.22-23). Second, the Panel required Petitioners to pay the Non-Neutral Arbitrator's fees, despite AAA rules forbidding this. (App.31-32). Third, the Panel inappropriately relied on the allegations of the SAC – an excluded pleading – to find Petitioners liable for

fraudulent concealment, even though Petitioners had no notice that these allegations would be at issue or opportunity to take discovery as to these allegations. (App.37-39).

The District Court rejected several additional grounds raised by Petitioners for vacatur. The District Court held that Petitioners could not challenge the timeliness of the Final Award because Petitioners' non-neutral panelist – Chernick – only filed his dissent on October 6, 2007, the Panel's last day to issue its award. (App.32-37). The District Court also rejected Petitioners' claims that they were prejudiced by Panel-member bias and that the Panel manifestly disregarded the law. (App.41-47).

On July 18, 2007, the District Court vacated the Fee Award in light of its vacatur of the Merits Award. (App.91-94). The District Court acknowledged that Respondents had concealed material facts from the Panel but rejected that there was clear and convincing evidence that Respondents' counsel had engaged in fraud because the Yatooma Firm – after submitting a false and perjurious Fee Application (that it supported with fraudulent and perjurious affidavits and deposition testimony) – had acknowledged certain of these misdeeds to the Panel in the final hearing on the Fee Application. (App.88-91). The District Court was unmoved by the fact that much of Respondents' counsel's acts of fraud, spoliation of evidence and perjury were first revealed on appeal to the District Court and were never known by the Panel. (App.67-77).

10. The Ninth Circuit Considers The Appeal Even After The District Court Agrees To Rehear Certain Matters

On June 28, 2007, Respondents moved the District Court to direct a rehearing by the arbitrators. (App.96). On August 6, 2007, Respondents filed their notice of appeal to the Ninth Circuit. On August 29, 2007, the District Court partially granted Respondents' Motion for Rehearing directing a new arbitration panel to consider what damages, if any, were attributable to the Panel's findings of breach of the covenant and interference with business relationships. In ordering a new panel, the District Court noted "the record in this matter discloses a pattern of shenanigans and open acrimony among all parties involved that leaves this Court hesitant to entrust further proceedings" to the original Panel. (App.104).

Even though Respondents' rehearing motion was pending before the District Court, the Ninth Circuit accepted the appeal.

11. The Ninth Circuit Reinstates The Final Award

The District Court's two opinions vacating the Final Award run multiple pages and contain supporting detailed facts. (App.5-95). On June 16, 2009, the Ninth Circuit issued a 2-½ page, unpublished opinion that reversed the District Court and reinstated the Final Award. (App.1-4). Despite the District Court's finding that the Panel's fraudulent concealment

findings against Petitioners were based on the excluded SAC, the Ninth Circuit concluded:

> [W]e are satisfied that the [FAC] adequately gave TKC notice and an opportunity to be heard on the issue of fraudulent concealment upon which the case ultimately turned, and that all of the evidence upon which the Panel relied was within the notice provided by the [FAC].

(App.3). The Ninth Circuit cited nothing to support this conclusion.

The Ninth Circuit then ruled that, because it was restoring the Merits Award, it followed that it would restore the Fee Award. (App.3). The Ninth Circuit ignored entirely that most of the evidence of fraud, spoliation and perjury involving the Fee Application first materialized before the District Court and was never addressed by the Panel. The Ninth Circuit also ruled, despite the FAA Rules and without explanation, that "[g]iven the facts of this case, it was within the arbitrator's discretion to impose a portion of Hazlewood's arbitrator's costs on TKC." (App.3).

The Ninth Circuit next concluded that, despite the District Court's detailed findings otherwise, California law would void the parties' agreed damage limitations because "it rises to the level of an exemption from responsibility for fraud." (App.3-4).

The Ninth Circuit never addressed Petitioners' cross-appeal or the several additional bases for vacatur that the District Court had rejected.

As to jurisdiction, the Ninth Circuit determined that its ruling mooted Respondents' rehearing motion. (App.4).

Petitioners timely filed their Rehearing Petition on July 1, 2009. The Ninth Circuit denied this on July 24, 2009. (App.175-76).

B. The District Court Had Proper Jurisdiction Over This Appeal

The FAA allows for the appeal of a final arbitration award to a United States District Court in the district wherein the award was made to determine if the award should be vacated. 9 U.S.C. §10(a). The Final Award was issued in San Francisco, California, which is in the territory of the District Court here. The matter also arises under the FAA, a law of the United States, making jurisdiction further proper under 28 U.S.C. §1331.

REASONS FOR GRANTING THE PETITION

In enacting the FAA, Congress sought to encourage parties to pursue arbitration and other forms of alternative dispute resolution as a means of avoiding costly, burdensome and unnecessary litigation. *E.g., Advanced Bodycare Solutions, LLC v. Thione Intern., Inc.*, 524 F.3d 1235, 1239-40 (11th Cir. 2008). Congress also established a federal policy favoring arbitration that required courts to rigorously enforce

arbitration agreements by private parties. *See Shearson/ Am. Exp., Inc. v. McMahon*, 482 U.S. 220, 226 (1987). However, the Ninth Circuit's decision, unless reversed by this Court, will lead parties to fear arbitration by eroding their confidence that a federal court will conduct meaningful judicial review of an arbitration to ensure that it is fair, as promised by the FAA. Here, the Final Award, and the manner in which the Panel both awarded damages to Respondents and fees to Respondents' counsel, breached every element of a fair arbitration set forth in FAA §10(a). Even though the District Court vacated both the Merits Award and Fee Award, the Ninth Circuit perfunctorily reinstated the Final Award and reversed the District Court. Each explanation the Ninth Circuit gave for its reversal revealed errors. Certiorari is now necessary for three independent reasons:

First, the Ninth Circuit ignored the Court's specific mandate in *Volt* that parties must be free to "specify by contract the rules under which [the] arbitration will be conducted." 489 U.S. 468, 479 (1999). This Court reaffirmed the deference that panels must accord to parties' arbitration choices in *Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52 (1995). The Ninth Circuit therefore "decided an important federal question in a way that conflicts with relevant decisions of this Court." S. Ct. Rule 10(c). The Ninth Circuit's decision denied Petitioners the benefit of the parties' arbitration agreement in at least four material ways:

- Despite the parties' agreement that the issues would be shaped by pleadings and

subject to discovery, the Ninth Circuit upheld a finding of liability for fraudulent concealment against Petitioners based on allegations found solely in the SAC, a rejected pleading.

- While the parties agreed to exclude consequential and lost profit damages from any arbitration award, the Ninth Circuit reinstated such damages, concluding, erroneously, that Petitioners would otherwise be "exempt" from punishment for fraud.
- Despite the parties' agreed deadline for a final award, the Ninth Circuit upheld an award issued four days late.
- Despite the parties' agreed time for conducting the Arbitration, the Ninth Circuit allowed the Panel to free Respondents' attorneys from the consequences of their failure to complete their case on time.

Second, this Court should exercise its supervisory powers because the Ninth Circuit so far departed from the accepted and usual course of judicial proceedings in reviewing an arbitration award, resulting in a gross miscarriage of justice. S. Ct. Rule 10(a). The FAA provides that, where a panel has exceeded its authority or otherwise denied a party a fair arbitration, a District Court, upon proper application, should vacate that award. Here, the District Court made extensive factual findings that showed that the Panel had exceeded its authority and denied Petitioners a fair arbitration. Despite FAA §10(a)'s

requirements, the Ninth Circuit summarily rejected the District Court's factual and legal findings and reinstated the Final Award. This denied Petitioners a fair hearing in at least the following material ways:

- Despite governing rules forbidding this, the Final Award required Petitioners to pay fees of their opponents' Non-Neutral Arbitrator. This was especially improper since the Non-Neutral Arbitrator had repeatedly engaged in unethical and sanctionable behavior and was, in effect, rewarded for this.
- The Panel's purportedly "neutral" member engaged in unfair bias, including hugging and kissing the opponent.
- Perhaps most egregiously, despite blatant and admitted fraud, spoliation of evidence and perjury by Respondents' law firm, the Ninth Circuit reinstated a substantial Fee Award that rewarded such malfeasance.

Third, the Ninth Circuit acted contrary to the Third Circuit in *Virgin Islands* and other Circuit authority in exercising appellate jurisdiction because it allowed this appeal to proceed even after the District Court referred the matter to a new panel for rehearing. The grant of rehearing should have mooted this appeal as premature. The inconsistency in lower court approaches highlights an important question of federal law that has not been but should be settled by this Court. S. Ct. Rule 10(c).

A. The Ninth Circuit's Decision Conflicts With This Court's Mandate In *Volt*

In *Volt*, the Court emphasized that Congress' principal purpose in passing the FAA was to ensure "that private arbitration agreements are enforced according to their terms." *Volt*, 489 U.S. at 478. Indeed, this Court noted there that parties could agree upon rules for arbitration that differed from what the FAA would otherwise require, noting "the FAA's primary purpose of ensuring that private agreements to arbitrate are enforced according to their terms" and that parties may "specify by contract the rules under which that arbitration will be conducted." *Id.* at 479.

Thus, in *Volt*, where the parties agreed that the California Arbitration Act would apply, this Court held that they were entitled to a stay of an arbitration pending the completion of a third-party lawsuit even though the FAA, absent the parties' agreement, would not have stayed the arbitration.

Again in *Mastrobuono*, 514 U.S. 52, this Court refused to enforce a New York law that forbade the recovery of punitive damages in an arbitration where the parties agreed to abide instead by National Association of Securities Dealers rules that allowed such damages.

In key respects, the Panel overrode the parties' agreement as to how their arbitration would proceed and the Ninth Circuit, by reinstating the Final Award

over the District Court's vacatur, improperly permitted this.

1. The Panel Improperly Relied On Excluded Material To Hold Petitioners Liable For Fraud

It is undisputed that the parties agreed that their Arbitration would be governed by AAA Commercial Arbitration Rules (LD1 ¶4) and that issues would be subject to formal pleadings and discovery. Based on these rules, the Panel acknowledged that the operative pleading in the Arbitration was the FAC. (LD1 ¶112, Ex. 14 at 2731:12-17). While Respondents attempted belatedly to introduce an SAC, the Panel denied this. (*Id.*). The SAC, therefore, cannot support any finding. Despite this, the Panel used the SAC to hold Petitioners liable for fraud. As the District Court concluded:

> Reviewing the Final Award, much of the factual basis for [Petitioners'] fraud liability (the sole claim on which [Respondents] were awarded damages), stems from conduct alleged only in the SAC. The majority discussed [Petitioners'] failure to advise [Respondents] of the "inherent risk involved in becoming an art gallery owner" beyond the specific risks associated with competing with other Thomas Kinkade galleries. Final Award at 9; SAC ¶¶31-32. Additionally, the majority devotes substantial discussion to [Petitioners'] presentation of financial information related to the Signature Gallery

> program, and [Petitioners'] failure to inform [Respondents] of the changed financial conditions of TKC and other Signature Gallery dealers during the time between the initial presentation of financial information and the execution of the first Dealer Agreement. Final Award at 9. These allegations appear in the SAC, but nowhere in the FAC. SAC ¶¶33-34, 42. While there were other bases for fraud liability that were pled both in the FAC and SAC, the majority improperly relied on allegations and evidence related to a pleading that the Panel had explicitly rejected, without affording [Petitioners] an opportunity to conduct discovery or present evidence in rebuttal. This is plainly at odds with the requirements of the FAA, and warrants vacatur of the award.

(App.39-40).

The Ninth Circuit rejected these findings. As noted above, in reinstating the Merits Award, it held that "we are satisfied that the [FAC] adequately gave TKC notice and an opportunity to be heard on the issue of fraudulent concealment upon which the case ultimately turned." (App.3).[7] This is simply untrue.

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[7] In reversing the District Court, the Ninth Circuit repeatedly ignored the governing standard of review. Under *Barnes v. Logan*, 122 F.3d 820, 821 (9th Cir. 1997), a district court's findings of facts in a decision to vacate or confirm an arbitration award are to be reversed only if they are clearly erroneous. This Court has held that "[t]his standard policy does not enable a reviewing Court to reverse the finding of fact simply because it

(Continued on following page)

The Ninth Circuit could not by fiat decree that the FAC gave notice of issues that are never mentioned in that pleading.

2. The Panel Improperly Overrode The Parties' Agreement To Exclude Lost Profit And Consequential Damages

Of the damages awarded by the Panel, only $122,000 were for out-of-pocket losses. The remainder – or more than $738,000 – were for loss of business or opportunity. These are, in essence, lost profit or consequential damages, as the Panel acknowledged. Yet the Panel concluded that, despite the parties' unequivocal agreement to exclude such damages, it would allow them anyway in light of California Civil Code Section 1668, which outlaws contractual provisions "that exempt anyone from responsibility for his own fraud." (App.3).

To begin with, *Volt* and *Mastrobuono* both concern instances where parties agreed to an exception from what state law would ordinarily apply. There is

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is convinced that it would have decided the case differently." *Anderson v. Bessemer City*, 470 U.S. 564, 573 (1985). Moreover evidence is not "irrelevant" where it addresses facts that were material to an arbitration opinion. In addition, the Ninth Circuit allowed Petitioners to be liable where they effectively could mount no defense. The Panel denied four proffers of fact made by Petitioners' counsel regarding the SAC's allegations, denied Petitioners discovery as to the SAC, and would not reopen the hearing to let Petitioners rebut these allegations.

no reason why the parties here could not contract around Section 1668, even assuming it applied.

More importantly, the lost profits provision in the parties' Dealer Agreements does not "exempt" petitioners from fraud liability. An exemption means to be "[f]reed as from a duty, liability or other requirement." Black's Law Dictionary (8th ed.) at 612. "Immunity" is referenced. *Id.* Here, Petitioners do not claim "immunity" from fraud. They do not contest that, if liability were properly found, they could be liable for out-of-pocket damages.

Finally, the Ninth Circuit misconstrued California law which allows parties to a commercial arbitration to exclude certain forms of damages where others are available. *E.g., Farnum v. Superior Court*, 70 Cal. Rptr. 2d 85 (Cal. Ct. App. 1997). California law specifically provides that parties in a commercial arbitration may agree to insulate both sides from damages for lost profits. *See O'Flaherty v. Belgum*, 9 Cal. Rptr. 3d 286, 299-300 (Cal. Ct. App. 2004).

3. The Panel Deprived Petitioners Of The Benefit Of Their Agreed-Upon Time Limits

It is undisputed that the parties agreed to evenly split the last 10 hearing days in the Arbitration. (LD1, Ex. 9, 1362:1-1371). It is also undisputed that Respondents' counsel failed to finish his case as agreed and required an extension. (LD1 ¶83). Over Petitioners' strenuous objection, the Neutral Arbitrator

granted this request, thereby denying Petitioners the benefit of their agreement. (LD1 ¶¶84-85). This rewarded Respondents' counsel's inefficiency, while denying Petitioners the benefit of their efficiency in organizing their case. While Petitioners' cross-appealed this issue, the Ninth Circuit never addressed that, or indeed, any issue raised in Petitioners' cross-appeal.

4. The Panel Issued Its Final Award After The Parties' Agreed-Upon Deadline

Finally, there is no dispute that the parties agreed that California law would apply to the Arbitration. California's Civil Procedure Code §1283.8 provides that an arbitration award "shall be made within the time fixed therefor by the agreement. . . ." California courts have long held that, where a contract or the parties' agreement provides for the time within which an arbitration award is to be issued, "an arbitrator loses jurisdiction if a timely award is not forthcoming." *E.g., Baar v. Tigerman*, 211 Cal. Rptr. 426, 430 (Cal. Ct. App. 1983). The record is undisputed that the Final Award was untimely. To be timely it should have been issued by October 6, 2007 – the deadline to which the parties agreed (at the Neutral's request!) – but was instead issued October 10, 2007, four days late. Petitioners' counsel promptly objected to the Final Award's invalidity. (LD1 ¶8). Under California law, the Final Award was untimely and therefore invalid.

The District Court recognized the parties' agreement but concluded that applying it here would be unfair because Chernick did not finish his dissent until the last date. This ignored that the dissent was immaterial to the Final Award, which was self-contained and could have been issued without the dissent. Moreover, even with the dissent, there remained time on October 6 for the Panel to issue the Final Award. The Panel Majority without explanation, simply did not do so.

B. This Court Should Exercise Its Supervisory Power To Correct The Ninth Circuit's Departure From The Accepted And Usual Course Of Judicial Proceedings When It Reinstated A Final Award That Rewarded Ethical Violations, Sanctionable Conduct And Fraud

The FAA directs a reviewing court to vacate an arbitration award "where the award was procured by corruption, fraud or undue means;" "where there was evident partiality or corruption in the arbitrators, or either of them;" where the arbitrators were guilty of "any other misbehavior by which the rights of any party have been prejudiced;" or "where the arbitrators exceeded their powers." This is a rare arbitration where each of these elements for vacatur was met. The District Court found that vacatur was required as to both the Merits Award and the Fee Award, even while it rejected several of Petitioners' grounds for such relief. The Ninth Circuit, with only

the most perfunctory explanation, reinstated such a tainted Final Award. This Court should now exercise its supervisory power to protect parties' right to meaningful judicial review under the FAA.

1. The Panel Violated Controlling Law By Shifting The Non-Neutral Arbitrator's Fees To Petitioners

The Panel Majority erroneously concluded that they had "discretion" to shift the compensation of Respondents' Non-Neutral Arbitrator to Petitioners because Rule 43 allows an arbitrator to craft an award that is "just and equitable." (App.136). Rather, R-43(a) is modified by the more restrictive language of other subsections. This includes AAA Rule R-43(c), which provides, "[i]n the final award, the arbitrator shall assess the fees, expenses and compensation provided in Sections R-49, R-50 and R-51. The arbitrator may apportion such fees, expenses and compensation among the parties in such amounts as the arbitrator determines is appropriate." The plain language limits a panel's ability to apportion fees that are not set forth in Rules R-49 (administrative fees), R-50 (witness fees) and R-51 (neutral arbitrator's fees). Here, R-51 provides only for compensation of the neutral arbitrator by the losing party. As the District Court concluded, "when a statute limits a thing to be done on a particular mode, it includes a negative of any other mode." (App.32) (quoting *Longview Fiber Co. v. Rasmussen*, 980 F.2d 1307, 1312-13

(9th Cir. 1992)). The maxim *expressio uniis est exclusio alterius* further dictates this result.

Here, it was especially inappropriate to require Petitioners to pay the Non-Neutral Arbitrator's fee where he had engaged in sanctionable behavior toward Petitioners and their witnesses. (LD1 ¶¶100-109). He also breached his ethical obligations by failing to disclose his *de facto* financial interest in Respondents' victory. (LD1 ¶¶150-51). While Petitioners sought discovery as to his payment arrangement, the "Neutral" – evidencing his actual non-neutrality – refused to grant this. (*Id.*). *E.g., Pour Le Bebe, Inc. v. Guess?, Inc.*, 112 Cal. App. 4th 810 (2003) (unethical conduct constitutes arbitrator's "undue means").

2. The Purportedly "Neutral" Arbitrator Was Biased

It is undisputed that Respondents' Non-Neutral Arbitrator frequently lobbied the Neutral Arbitrator. (LD1 ¶89). The record is further undisputed that Respondents' Non-Neutral Arbitrator tried to poison the well against Petitioners by making false statements to the Neutral about the separate White Arbitration. (LD1 ¶¶89-92). That this strategy worked is evident in the Neutral's overriding the parties' agreed-upon time limits for the Arbitration, as discussed above; by his refusal to grant Petitioners' discovery into the Non-Neutral's fees or his ethical violations; and, most obviously, by hugging and kissing

Ms. Hazlewood. Needless to say, Petitioners were not showered with such affection. *E.g., Morelite Constr. Corp. v. New York City Dist. Council Carpenters Ben. Funds*, 748 F.2d 79 (2d Cir. 1984) (bias requires vacatur).

3. The Final Award Rewarded Respondents' Attorneys' Fraud, Spoliation Of Evidence And Perjury

Respondents' attorneys engaged in a series of egregious and unconscionable behaviors in an effort to recover as much money as possible from Petitioners. This included:

- lying to the Panel about whether hard copies of timesheets existed (LD2 ¶¶61, 63, 80-81);
- destroying billing records that evidenced fraud (LD2 ¶62);
- vastly inflating the number of hours claimed to have been spent by attorneys on this matter (LD2 ¶85);
- inflating the claimed hourly fee (LD2 ¶59);
- trying to charge Petitioners for costs and fees incurred in other matters (LD2 ¶81);
- trying to charge Petitioners for fees and costs other parties had already paid (LD2, Exs. 22 & 24);

- offering perjured testimony to protect their scheme and instructing Firm employees to lie. (*E.g.*, LD1, Ex. 34 at 8240:12-16, 8242:5-20, 8266:4-16).

Despite this behavior, the Panel awarded the malfeasors $900,000 – nearly $40,000 more than they awarded Respondents as damages. (App.138).

The Panel was unaware of the extent of Respondents' counsel's fraud, as discovery that first occurred before the District Court revealed for the first time that Respondents' counsel had instructed firm employees to lie and had manufactured false timesheets which showed attorneys billing many multiples of hours over what they actually spent. This is a stark illustration of an award "procured by fraud," exactly what FAA §10(a)(1) instructs a court to vacate. *See Commonwealth Coatings Corp. v. Cont. Cas. Co.*, 393 U.S. 145, 148 (1968) (FAA's corruption fraud section was designed to provide "not merely for an arbitration but for an impartial one").

Despite such abundant new evidence of fraud, spoliation and perjury first revealed on appeal, the Ninth Circuit simply reinstated the Fee Award, finding that because it was reinstating the Merits Award, it necessarily followed that it would reinstate the Fee Award. This rewarded Respondents' counsel's outrageous misdeeds that, in other contexts, might have gotten them disbarred. Unless reversed, the gross miscarriage of justice caused by the Fee Award

here will undermine future parties' willingness to enter into arbitrations.

C. The Ninth Circuit Exercised Jurisdiction Over This Appeal Even After The District Court Directed The Panel To Reconsider Certain Matters In Response To A Petition For Rehearing, Creating A Conflict With The Third Circuit's Decision In *Virgin Islands*

Prior to filing their notice of appeal on August 6, 2007, on June 28, 2007, Respondents moved for rehearing. On August 29, 2007, the District Court granted Respondents' rehearing petition and ordered limited rehearing before a new arbitration panel. Under established law, including *United Nat'l Ins. Co. v. R&D Latex Corp.*, 242 F.3d 1102, 1109 (9th Cir. 2001) – an earlier Ninth Circuit decision – and the Third Circuit's decision in *Virgin Islands*, 27 F.3d 911 (3d Cir. 1994), the District Court's order granting rehearing and referring the matter to a new panel made any exercise of appellate court jurisdiction premature.

In *Virgin Islands*, the District Court vacated an arbitration award, but remanded the case back to the arbitrator for further proceedings when it determined that certain expenses claimed by the prevailing party may have been false. The Third Circuit held the vacatur order was unappealable. The Court noted that if the District Court had simply vacated the award, the vacatur order would have been immediately appealable. The remand for additional

proceedings, however, changed the order's appealability. The Third Circuit held that if a rehearing is ordered by a district court " . . . merely for purposes of clarification" of an award, a vacatur order is not appealable, at least not until the arbitrator clarifies the award. *Id.* at 914.

This is precisely this case. Following Respondents' Rehearing Motion, the District Court concluded that the Merits Award was ambiguous, and that it should be returned to an arbitration panel to determine the extent and allocation of damages. (App.99-105). Yet, the Ninth Circuit allowed the clarification order to, in essence, be mooted by proceeding with the appeal nevertheless. To clarify this important issue in the face of opposing Circuit views, this Court should intervene.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDICES

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS,

FOR THE NINTH CIRCUIT

THE THOMAS KINKADE COMPANY, FORMERLY KNOWN AS MEDIA ARTS GROUP, INC., and RICHARD F. BARNETT, Plaintiffs-Appellants, v. KAREN HAZLEWOOD; JEFFREY SPINELLO and THOMAS KINKADE AT THE DOWNTOWN MALL, LLC, Defendants-Appellees.	No. 07-17119 D.C. No. CV 06-07034 MEMORANDUM* (Filed June 16, 2009)

Appeal from the United States District Court
for the Northern District of California
Marilyn H. Patel, District Judge, Presiding

Argued and Submitted May 7, 2009
San Francisco, California

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* This disposition is not appropriate for publication and is not precedent except as provided by Ninth Circuit Rule 36-3.

Before: HAWKINS, TALLMAN, Circuit Judges, and SINGLETON,** Senior District Judge.

Karen Hazlewood, Jeff Spinello and Thomas Kinkade at the Downtown Mall, LLC, (collectively, "Hazlewood") appeal the district court's June 6 and July 18, 2007 orders vacating an arbitration award in their favor. The Thomas Kinkade Company, LLC, and Richard Barnett (collectively, "TKC") appeal the district court's August 29, 2007 order granting a motion for a limited rehearing before a new arbitration panel. We reverse the district court's orders and direct reinstatement of the arbitration award.

We are satisfied that, taken together, the numerous orders entered by the district court constitute a final judgment giving us jurisdiction over this appeal. 9 U.S.C. § 16(a)(3) and 28 U.S.C. § 1291.[1]

The district court divided the arbitration award into two components for purposes of evaluation. First, it considered the award on the merits and vacated it in an order dated June 6. In so doing, it erred by failing to afford arbitration the deference required by federal law. *See Coutee v. Barington Capital Group,*

** Honorable James K. Singleton, Jr., Senior District Judge, District of Alaska, sitting by designation.

[1] It is therefore not necessary for us to determine whether we might also have jurisdiction over the June 6 order on the theory that it merged into the July 18 order permitting a global interlocutory appeal under 9 U.S.C. § 16(a)(1) and 28 U.S.C. § 1292.

336 F.3d 1128, 1132 (9th Cir. 2003). We are satisfied that the First Amended Complaint adequately gave TKC notice and an opportunity to be heard on the issue of fraudulent concealment upon which the case ultimately turned, and that all of the evidence upon which the panel relied was within the notice provided by the First Amended Complaint. Further, the arbitrators could well conclude that all of the additional evidence proffered by TKC was either irrelevant or cumulative. TKC received a fair hearing from the arbitrators.

The district court next addressed the award of costs and fees and vacated that award in an order dated July 18. TKC challenged this aspect of the award on many grounds. Ultimately, the district court concluded that the award of costs and fees depended upon the award on the merits vacated in the June 6 order and set it aside on that basis. Since we are setting aside the June 6 order, we vacate the July 18 order as well.

A few additional remarks are in order. First, AAA Commercial Arbitration Rule R-43 allows an arbitrator to craft an award that is just and equitable. Given the facts of this case, it was within the arbitrator's discretion to impose a portion of Hazelwood's arbitrator's costs on TKC.

Second, we are satisfied that the California Supreme Court would find that California Civil Code § 1668 voids the attempt in the contract to limit damages for lost profits because, in context, it rises to

the level of an exemption from responsibility for fraud. *See, e.g., Health Net of California, Inc. v. Dep't of Health Servs.*, 113 Cal. App. 4th 224, 240-41 (2003).

Finally, we are satisfied that under California law a recision [sic] of a contract for fraud is not inconsistent with an award of consequential damages to the defrauded party.

Our decision to set aside the orders vacating the arbitration award on June 6 and July 18 resulting in the reinstatement of the award serves to moot the district court's order of August 29, which transformed the complete vacation of the arbitration award on June 6 into a partial vacation.

Accordingly, the district court's orders of June 6, July 18, and August 29 are VACATED and this case is REMANDED to the district court with instructions to reinstate the arbitration award.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

THE THOMAS KINKADE COMPANY, f/k/a MEDIA ARTS GROUP, INC., a California corporation and RICHARD F. BARNETT,

Plaintiffs,

v.

KAREN HAZLEWOOD, JEFF SPINELLO, and THOMAS KINKADE AT THE DOWNTOWN MALL, LLC, a Virginia corporation,

Defendants. /

No. C 06 7034 MHP

MEMORANDUM & ORDER
Re: Plaintiffs' Motion to Vacate Arbitration Award

(Filed Jun. 6, 2007)

Plaintiffs The Thomas Kinkade Company ("TKC") and Richard F. Barnett (collectively "plaintiffs") bring this motion [sic] vacate an arbitration award issued in favor of Karen Hazlewood, Jeff Spinello and Thomas Kinkade at the Downtown Mall, LLC (collectively "defendants") in October 2006. Plaintiffs claim that the award exceeds the arbitrators' powers, that the award was procured by undue means and fraud, that the neutral arbit ator was biased, that the defendants' non-neutral arbitrator was corrupt, that the award was untimely issued and therefore null, that the award manifests complete disregard for the law, and that the damage award is wholly speculative and irrational. Having considered the arguments of the

parties and for the reasons set forth below, the court enters the following memorandum and order.

BACKGROUND[1]

I. Business Dealings Between the Parties

Plaintiff The Thomas Kinkade Company, formerly known as Media Arts Group, Inc.,[2] is a California corporation with its principal place of business in Morgan Hill, California. Plaintiff manufactures, markets, distributes and licenses reproductions of artwork based on the paintings of Thomas Kinkade.[3] Levitt Dec. ¶¶ 13-14. Richard Barnett, a California resident, is the Senior Vice President of TKC and held the same position with Media Arts Group, Inc. Barnett helped create and manage the "Signature Gallery Program," which serves as the main channel of distribution for TKC's merchandise. *Id.* ¶ 16.

Defendants Karen Hazlewood and Jeff Spinello (collectively "the Hazlewoods") are individuals residing in Virginia. Defendant Thomas Kinkade at the Downtown Mall, LLC is or was a Virginia limited

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[1] Unless otherwise indicated, the background facts are taken from the parties' submissions, declarations, and attachments thereto.

[2] Throughout this order, the abbreviation "TKC" refers to both The Thomas Kinkade Company and Media Arts Group, Inc.

[3] Thomas Kinkade himself is not a party to these proceedings.

liability company owned and operated by the Hazlewoods.

Pursuant to the Signature Gallery Program, TKC entered into two "Signature Gallery Dealer Agreements" ("Dealer Agreements") with the Hazlewoods in January 1999 and March 2000. *Id.* ¶¶ 22-23. The Hazlewoods opened a gallery in Charlottesville, Virginia in March 1999 pursuant to the first agreement and a second gallery in Fredericksburg, Virginia in December 2000 pursuant to the second agreement. *Id.* Both galleries failed and were closed in March and November 2003, respectively.

The Dealer Agreements both contained identical arbitration clauses. *Id.* ¶¶ 31-35. The Agreements provided:

> **THE PARTIES AGREE THAT ALL DISPUTES BETWEEN THEM SHALL FIRST BE SUBMITTED FOR INFORMAL RESOLUTION TO THEIR CHIEF EXECUTIVE OFFICERS, OR IF NO CHIEF EXECUTIVE OFFICER, TO THE OWNERS. ANY REMAINING DISPUTE SHALL BE SUBMITTED TO A PANEL OF THREE (3) ARBITRATORS WITH EACH PARTY CHOOSING ONE (1) PANEL MEMBER, AND THE THIRD PANEL MEMBER BEING CHOSEN BY THE FIRST TWO (2) PANEL MEMBERS. THE PROCEEDINGS SHALL BE CONDUCTED IN ACCORDANCE WITH THE COMMERCIAL ARBITRATION RULES OF THE AMERICAN ARBITRATION**

> **ASSOCIATION. THE AWARD OF THE ARBITRATORS SHALL INCLUDE A WRITTEN EXPLANATION OF THEIR DECISION. *THIS ARBITRATION PROCEEDING WILL BE BINDING UPON THE PARTIES.***

Id., Exhs. 42 at 3920 & 43 at 3934 (all emphasis in original). The Agreements further provided for a period within which to submit disputes:

> Notice of all disputes shall be submitted to the other party within one (1) year from the date facts occur which create the basis for such dispute. Failure to provide notice of any dispute within such time shall result in waiver of right to submit any dispute relying upon such facts.

Id., Exhs. 42 at 3920 & 43 at 3933-34. The Agreements further placed limitations on damages available under the Agreements. In the section titled "Remedies and Liabilities," the Agreements provided, in part:

> **IN NO EVENT SHALL EITHER PARTY BE LIABLE HEREUNDER FOR ANY INDIRECT, INCIDENTAL OR CONSEQUENTIAL DAMAGES (INCLUDING LOST BUSINESS PROFITS) SUSTAINED BY THE OTHER PARTY OR ANY OTHER INDIVIDUAL OR ENTITY FOR ANY MATTER ARISING OUT OF, ABOUT, OR PERTAINING TO THE SUBJECT MATTER OF THIS AGREEMENT.**

Id., Exhs. 42 at 3919 & 43 at 3933 (all emphasis in original). The Dealer Agreements contain choice of law provisions for California law. *Id.*, Exhs. 42 at 3920 & 43 at 3934.

II. The Arbitration Proceeding

The Hazlewoods initiated an arbitration with the American Arbitration Association ("AAA") on September 26, 2003 against TKC, Barnett, and nineteen other individual respondents. *Id.* ¶ 37. The claim set forth twelve causes of action, including fraudulent concealment. *Id.* Specifically, the claim alleged that the respondents had fraudulently concealed three facts: (1) that the Dealer Agreements were franchise agreements; (2) that The Hazlewoods would be subject to TKC's Retail Sales Policy; and (3) that Barnett and other TKC employers were paid commissions on sales of art to Signature Dealers. *Id.* ¶ 38. TKC filed a counterclaim on November 22, 2003, alleging that the Hazlewoods owed $25,000 for merchandise that had been delivered to them. The Hazlewoods filed a First Amended Claim ("FAC") on January 2, 2004, adding their limited liability company as a claimant. *Id.* ¶ 44, Exh. 40 (hereinafter "FAC").

As provided for in the Dealer Agreements, each side appointed a non-neutral arbitrator to the Arbitration Panel ("the Panel"). Defendants appointed Mayer Morganroth, a Detroit, Michigan attorney who has also been selected as the non-neutral arbitrator in a separate arbitration against TKC involving

another Signature Dealer ("the White arbitration"). *Id.* ¶ 41. TKC appoint [sic] Los Angeles attorney Richard Chernick as its non-neutral arbitrator. *Id.* ¶ 40. Morganroth and Chernick then named James Grossman as the non-neutral arbitrator. *Id.* ¶ 43. According to plaintiffs, Morganroth and Grossman became "fast friends." *Id.* ¶ 43. Grossman allegedly picked up Morganroth at his hotel each morning and drove him to the arbitration, and the two men "almost always ate lunch together." *Id.* Defendants allege that Morganroth used this time with Grossman to improperly influence him, including by misrepresenting events in the White arbitration. *Id.*

On May 6, 2004, the Panel granted portions of TKC's motion to dismiss, dismissing eighteen of the individual plaintiffs (including Thomas Kinkade). *Id.* ¶¶ 53-55. As the arbitration proceeded, the parties engaged in additional motion practice and extensive discovery. *Id.* ¶ 45. The arbitration hearings began in December 2004. *Id.* ¶ 76. On April 6, 2005, defendants filed a motion for leave to file a Second Amended Claim ("SAC"), seeking to reinstate Kinkade as a respondent and presenting new allegedly concealed facts. *Id.* ¶¶ 113, 122, Exh. 83 (hereinafter "SAC"). The Panel denied the motion orally on April 18, 2005. *Id.* ¶ 112, Exh. 14, Transcript, Day 12 at 2731:12-17. The First Amended Complaint therefore remained the operative pleading. Defendants proceeded with their claim on a theory of lost profits rather than rescission, *Id.* ¶ 121. Defendants hired a

damages expert to testify as to the proper measure of damages. *Id.*

The parties filed closing briefs with the Panel on November 12, 2005. *Id.*, Exhs. 50 & 85. Plaintiffs assert that defendants' closing brief concentrated almost exclusively on the alleged instances of fraudulent concealment that had been set forth only in the rejected Second Amended Claim. *Id.* ¶ 122, Exh. 85. Accordingly, in its reply closing brief, TKC argued that the proposed Second Amended Claim was not the operative pleading, that TKC's discovery and its entire case were directed to allegations of the First Amended Claim, and argued that the Panel could not rule on the rejected claims in the Second Amended Complaint. *Id.* ¶ 124, Exh. 86. After closing arguments on December 5, 2005, TKC made four separate offers of proof, and requested additional hearing days to present evidence relevant to the allegations from the Second Amended claim. *Id.* ¶ 125, Exh. 88. The Panel denied the additional hearing dates, and the majority rejected each of the four offers of proof. *Id.* ¶ 126.

III. Alleged Misconduct During the Arbitration Proceeding

Plaintiffs have identified numerous incidents during the arbitration proceeding that they claim support vacating the award. These include purported misconduct by Morganroth, Grossman, and defense counsel.

A. Morganroth

Plaintiffs allege that defendants hired Morganroth as an arbitrator on a *de facto* contingency fee basis, and that this was not disclosed during the proceeding. Plaintiffs admit that they do not know the exact nature of Morganroth's fee arrangement due to an inability to take discovery related to the agreement during the arbitration proceeding. However, plaintiffs allege that Morganroth was never paid in full by Hazlewood and Spinello, and is currently owed at least $199,000. *Id.* ¶ 42. According to plaintiffs, "Mr. Morganroth understood from the very beginning that he would not be paid unless the Hazlewoods won the arbitration and won big." Mot. at 9. Plaintiffs claim that this created a financial interest in the outcome of the arbitration that Morganroth was required to disclose pursuant to Canon X of the AAA Code of Ethics for Arbitrators in Commercial Disputes (hereinafter "Canon X").

In addition, plaintiffs claim that Morganroth violated Canon X by failing to "act in good faith and with integrity and fairness." Specifically, plaintiffs assert that Morganroth (1) falsely accused TKC's counsel of criminal conduct,[4] (2) repeatedly interrupted

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[4] During Day 2 of the hearing, Morganroth criticized plaintiffs' counsel for apparently instructing deposition witnesses not to give their home addresses, and stated that "[i]n a criminal case, that would be obstruction of justice and you would be accused of being a criminal." Levitt Dec., Exh. 4, Transcript, Day 2 at 296:14-17.

counsel in a rude and aggressive way, (3) "beat up on TKC's witnesses," including interrupting and badgering TKC's Chief Financial Officer, and (4) interjected false claims about events in the White arbitration, including falsely implying that the White Arbitration Panel had found TKC and its counsel liable for discovery abuses. *Id.* ¶¶ 96-107.

B. Grossman

Plaintiffs also allege improper conduct on the part of Grossman, the neutral arbitrator. One of plaintiff's principal contentions regarding Grossman is that Grossman, as chair of the Panel, improperly changed the rules regarding time limits in the midst of the proceedings such that defendants were afforded the unfair advantage of additional time. *Id.* ¶¶ 78-80. According to plaintiffs, when TKC's counsel objected to the change in the rules and reminded Grossman that the Panel had placed time limits on each parties case months earlier, Grossman replied, "In your mind." *Id.* ¶ 80, Exh. 21, Transcript, Day 19 at 4594:22-4595:3. Plaintiff further claims that Grossman forced TKC's counsel to agree to the rule change by threatening to rule against TKC on a pending discovery motion. *Id.* 1182, Exh. 21, Transcript, Day 19 at 4597:21-4598:11.[5]

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[5] During Day 19 of the hearing, plaintiffs' counsel interpreted a comment by Grossman as "a little pressure, Mr. Grossman, to accede in the face of the Panel's prior rulings to allow

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In addition to the incident regarding the timing rule change, plaintiffs allege that Grossman's conduct demonstrated bias in favor of Hazlewood. Specifically, plaintiffs allege that on August 1, 2006, after a "bitterly contested, two-day hearing" on defendants' request for more than five million dollars in fees and costs, "Mr. Grossman gave a loving embrace and kiss to Ms. Hazlewood." Mot. at 3; André Dec. ¶ 3; Levitt Dec. ¶ 12; Zorina Dec. ¶ 2. Plaintiffs further claim that the alleged bias exposed by this act of physical affection "infected the entire hearing." Mot. at 3.

C. Defense Counsel

Plaintiffs assert that defense counsel ("the Yatooma Firm") engaged in substantial misconduct during the arbitration proceeding. The Yatooma Firm was sanctioned on multiple separate occasions by the Panel. *See* Levitt Dec., Exh. 1 (hereinafter "Final Award") at 13. The Yatooma Firm's alleged transgressions include: (1) repeated ex parte contact with an adverse party represented by TKC's counsel, (2) theft of a privileged email from TKC's headquarters during an inspection, (3) threats of criminal prosecution against Kinkade during his deposition, and (4) abusive tactics and language toward opposing counsel. *Id.* ¶¶ 60, 62-63 & 65, Exhs. 70 & 71.

Mr. Ejbeh to have cross examination when his time runs out when he shouldn't." Grossman denied that this was his implication.

Additionally, plaintiffs allege that the Yatooma Firm devised an elaborate scheme involving former TKC employee Terry Sheppard, whereby Sheppard secretly monitored the White arbitration proceeding and transmitted cross-examination questions to the Yatooma Firm lawyers in real time. *Id.*, Exhs. 66-74. Plaintiffs allege that Sheppard was paid for his involvement in this scheme, but that when Sheppard testified in the Hazlewood proceeding nine months earlier had explicitly denied receiving compensation from Mr. White, and was presented as a neutral, third-party witness despite being a paid consultant. *Id.* ¶ 68.[6]

IV. The Arbitration Award

The Panel issued a Majority Interim Award on February 23, 2006, finding that plaintiffs were liable for fraud in the amount of $860,000 and denying their counterclaim. *Id.*, Exh. 2 (hereinafter "Interim Award") at 12. Defendants were afforded an opportunity to make an application for attorneys' fees, costs, expenses and interest. *Id.* at 13. Additional discovery, briefing, and hearings took place regarding

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[6] Plaintiffs raise a separate set of arguments alleging that the Yatooma Firm's application for fees and costs was fraudulent. The court will consider these arguments in a separate order.

the fee application, and a final award was transmitted to the parties on October 10, 2006.[7] *Id.*, Exh. 1.

The Final Award confirmed that TKC and Barnett were liable for fraud, and dismissed the remaining claims and counterclaims. *Id.* The factual bases for fraud liability were: (1) plaintiffs "painted an unrealistic and misleading picture of the prospects of success for a dealer"; (2) Barnett failed to disclose his own "special relationship with Thomas Kinkade" and the resulting "lucrative advantages"; (3) failure on the part of plaintiffs to disclose the "inherent risk involved in becoming an art gallery owner"; and (4) plaintiffs' failure to advise defendants of relevant changes in financial conditions regarding corporate stores and other Signature Gallery dealers which impacted the information that plaintiffs initially provided to defendants. *Id.* at 9. The majority further found that Barnett was responsible for the misconduct of a purportedly independent financial consultant. *Id.* at 10.

Additionally, the majority determined that "any limitations on damages contained in" the Dealer Agreements "would be of no force or effect" in light of the majority's finding of fraud in the inducement of the contract. *Id.* at 5. The majority further found that

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[7] The final award was signed by Grossman and Morganroth on October 4, and by Chernick on October 6. The exact date on which the award was "made" for the purposes of applicable legal standards is in dispute, as discussed *infra*.

the disputes underlying defendants' claims were brought to the attention of plaintiffs as they arose, and that the fraud claims were not barred by the statute of limitations. *Id.* at 6-7, 10. With regard to Terry Sheppard, who was allegedly involved in a deceptive scheme with the Yatooma Firm, the majority stated that it "gave little if any weight to Sheppard or his testimony." *Id.* at 11.

In determining damages, the majority stated that while it "f[ound] some merit in the Claimants' experts [sic] arguments," it "determined that there must be a significant discount from the numbers provided by the Claimants' expert in determining damages for a number of reasons." *Id.* The majority then discussed four concerns tending to discredit the expert's estimations, and stated that it would "reduce the award by these factors described above which Claimants' expert left to the Panel to determine." *Id.* at 11-12. The final damage figure was $860,100, comprised of $122,500 in "out of pocket expenses" and $737,600 in "loss of income" and "the value of the possible sale of the business." *Id.* at 12.

In addition to these fraud damages, the Final Award added $900,000 in attorneys' fees, and allocated $200,000 of Morganroth's compensation to be paid by plaintiffs. *Id.* at 16. The final award also included awards of administrative fees, witness fees, and an allocation of the neutral arbitrator's compensation. *Id.*

LEGAL STANDARD

The Federal Arbitration Act ("FAA"), 9 U.S.C. sections 1 *et seq.*, allows a district court to vacate the decision of an arbitration panel in four situations:

> (1) where the award was procured by corruption, fraud, or undue means;
>
> (2) where there was evident partiality or corruption in the arbitrators, or either of them;
>
> (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
>
> (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10(a)(1)-(4). In addition to these statutory bases for vacatur, a federal court may vacate an arbitration award if "the award itself is 'completely irrational' or 'constitutes manifest disregard of the law.'" *Coutee v. Barington Capital Group, L.P.*, 336 F.3d 1128, 1132-33 (9th Cir. 2003) (quoting *G.C. & K.B. Invs., Inc. v. Wilson*, 326 F.3d 1096, 1105 (9th Cir. 2003)). In any case, "judicial review of an arbitration award is both limited and highly deferential." *Sheet Metal Workers' Int'l Ass'n Local Union No. 359*

v. Madison Indus., Inc., of Az., 84 F.3d 1186, 1190 (9th Cir. 1996). "Neither erroneous legal conclusions nor unsubstantiated factual findings justify federal court review of an arbitral award. . . ." *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, 341 F.3d 987, 994 (9th Cir. 2003). This court reviews an arbitrator's award cognizant of the repeated admonitions by the Supreme Court and the Ninth Circuit that section 10 is to be interpreted narrowly. *See, e.g., First Options of Chicago, Inc. v. Kaplan,* 514 U.S. 938, 943 (1995) (when the parties agree that an issue should be resolved by arbitration "the court should give considerable leeway to the arbitrator, setting aside his or her decision only in certain narrow circumstances"); *see also Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056, 1060 (9th Cir. 1991) (discussing "Supreme Court authority strictly limiting federal court review of arbitration decisions").

DISCUSSION

I. Whether the Majority Exceeded Its Powers

The Federal Arbitration Act allows vacatur "[w]here the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made." 9 U.S.C. § 10(a)(4). This subsection has been interpreted to allow a court to vacate an arbitration award where the arbitrators exceeded their authority by ruling on a matter not submitted to them or acting outside the scope of the contractual

agreement. *See Michigan Mut. Ins. Co. v. Unigard Sec. Ins. Co.*, 44 F.3d 826, 830 (9th Cir. 1995). In order to determine that arbitrators did not exceed their authority, courts must ensure that an award is based on the words of the contract and the conduct of the parties. *Id.* at 831 (quoting *Edward Hines Lumber Co. of Or. v. Lumber & Sawmill Workers Local No. 2588*, 764 F.2d 631, 635 (9th Cir. 1985)).

Plaintiffs assert that the majority exceeded its powers in four respects. First, plaintiffs claim that the Panel improperly heard disputes for which no notice was given. Second, plaintiffs assert that the Panel improperly awarded lost profits and consequential damages, which are prohibited by the Dealer Agreements. Third, plaintiffs argue that the Panel's award of non-neutral arbitrator fees was unauthorized. Finally, plaintiffs assert that the Final Award was untimely and therefore null.

A. Notice

The Dealer Agreements provided that notice of any dispute must be given within one year of the occurrence of the facts underlying the dispute, and that failure to give such notice will result in waiver of the right to submit that dispute to arbitration.[8] Levitt

[8] Plaintiffs rely heavily on *Gueyffier v. Ann Summers, Ltd.*, 50 Cal. Rptr. 3d 294 (Cal. App. 2d Dist. 2006) in support of their argument regarding notice. After plaintiffs filed the instant motion, the California Supreme Court granted review of *Gueyffier*. 53 Cal. Rptr. 3d 802 (2007). In light of this, and

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Dec., Exhs. 42 at 3920 & 43 at 3933-34. The Dealer Agreements did not specify the manner of providing notice, only that disputes were to be submitted first to CEOs or owners of each party for informal resolution. Plaintiffs assert that defendants made no effort in the arbitration to prove that they gave any notice of the disputes underlying any of their claims.

Both members of the Panel majority explicitly found that defendants had given some form of notice to plaintiffs regarding their various problems. The Final Award states that "[m]any issues arose between the parties subsequent to the entering into of the Deal Agreement and in many instances the nature of the dispute was made known by Claimants to Media Arts. These issues have been well documented in the extensive briefing in this matter." Final Award at 7. Morganroth's concurrence to the Interim Award likewise states that "[t]he issues regarding disputes being submitted for informal resolution was heard in motions, and it was well supported that complaints were made regarding these matters, which Claimants were aware of before filing proceedings." Interim Award, Morganroth Concurrence at 2. The Panel therefore found that the notice requirements had been satisfied.

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because the court's analysis of the notice issue does not depend on *Gueyffier*, the court does not consider the parties' arguments related to that case.

Because the Dealer Agreement is vague as to what constitutes sufficient notice, and because the question of whether notice was provided is one of fact, plaintiffs challenge in this regard is an attempt to overturn the Panel's interpretation of the Dealer Agreement and factual findings. The court finds that plaintiff has not made a sufficient showing that the Panel exceeded its authority by determining that notice had properly been given under the terms of the Dealer Agreement.[9]

B. Lost Profits

The Final Award included $737,600 in "loss of income which could have been earned" and "the value of the possible sale of the business." Final Award at 12. Plaintiffs claim that this portion of the award goes beyond the Panel's authority because the Dealer Agreement expressly disclaims liability for "indirect, incidental or consequential damages (including lost business profits). . . ." Levitt Dec., Exhs. 42 at 3919 & 43 at 3933. Resolution of this issue requires the court

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[9] Although plaintiffs characterize the notice issue as jurisdictional, the Panel's interpretation of the facts and contracts are nonetheless entitled to deference. It is undisputed that the Panel had jurisdiction over properly notice [sic] disputes. The Panel's determination as to whether the disputes at issue were properly noticed is therefore within its discretion. This is therefore distinguishable from the lost profits argument, discussed *infra*, in which the Panel determined that it possessed jurisdiction over a matter that was specifically excluded from the Dealer Agreement.

to determine first whether the damages limitation is applicable, and if so, whether the damages limitation is legally valid.

1. Applicability

In response to plaintiffs' argument regarding the operation of the damages limitation, defendants claim that this provision is inapplicable to the arbitration proceeding, because it is a term of the overall contract rather than the arbitration clause. Defendants assert that the Panel was empowered to resolve "'all disputes' under the Agreement," Opp. at 32, and that this authority encompassed the awarding of lost profits and other consequential damages. Furthermore, the majority itself stated that the contractual limitations on damages were inoperative because the Dealer Agreement was set aside based on fraud in the inducement. Final Award at 5.

In a commercial arbitration, "an arbitrator ' . . . does not sit to dispense his own brand of industrial justice . . . (h)is award is legitimate only so long as it draws its essence from the . . . agreement.'" *Coast Trading Co. v. Pac. Molasses Co.*, 681 F.2d 1195, 1197-98 (9th Cir. 1982) (quoting *United Steelworkers of Am. v. Enter. Wheel & Car Corp.*, 363 U.S. 593, 597 (1960)). Here, the Panel's authority extended over "all disputes" arising from the agreement. The agreement itself explicitly and unequivocally states that plaintiff shall not "be liable *hereunder* for any indirect, incidental or consequential damages (including lost

profits) . . . *for any matter arising out of, about, or pertaining to the subject matter of this agreement.*" Levitt Dec., Exhs. 42 at 3920 & 43 at 3933 (emphasis added). The damages limitation is therefore inextricably linked to the arbitration provision, and the two clauses must be read together. The Panel, taking jurisdiction over a dispute arising from the Dealer Agreement and acting pursuant to the terms of the same agreement, could not go beyond these parameters.[10] The Panel's award of lost profits and business value therefore plainly exceeded its authority.

Defendants argue that this is a matter of contract interpretation, and that this court must defer to the Panel's interpretation of the agreement. *See San Francisco-Oakland Newspaper Guild v. Tribune Publ'g Co.*, 407 F.2d 1327, 1327 (9th Cir. 1969) (per curiam) (holding that "so far as the arbitrator's decision concerns construction of the contract, the courts have no business overruling him, because their interpretation of the contract is different than his."). However, "where the arbitrator exceeds the express limitations of his contractual mandate, judicial deference is at an end," and jurisdictional challenges focusing on whether an award is grounded in a

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[10] This view is confirmed by the AAA rules themselves, which provide that "[t]he arbitrator may grant any remedy or relief that the arbitrator deems just *and equitable and within the scope of the agreement of the parties*, including, but not limited to, specific performance of a contract." AAA Commercial Arbitration Rule R-43(a) (emphasis added).

contract are considered *de novo*. *See Delta Queen Steamboat Co. v. Dist. 2 Marine Eng'rs Beneficial Ass'n*, 889 F.2d 599, 602 (9th Cir. 1989). Arbitrators are not free to interpret commercial agreements to give themselves more power than the parties bargained for.

The inquiry in this action, however, is complicated by the fact that the majority purported to set aside the Dealer Agreement. As a general matter, "an arbitration provision is severable from the remainder of the contract," and therefore a finding of contract invalidity does not affect the applicability of an arbitration clause. *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 126 S.Ct. 1204, 1209 (2006) (holding that an arbitration clause in an otherwise usurious contract was enforceable where the validity of the arbitration clause was not specifically challenged). Even if the arbitration clause is severable from the Dealer Agreement, however, a question exists as to whether the damages limitation set forth in a separate section of the Dealer Agreement remains operative along with the arbitration clause.

In light of the severability between arbitration provisions and the remaining contractual provisions, the court must consider the arbitration clause to be a contract for arbitration in and of itself, and give effect to the nature and scope of arbitration to which the parties agreed. "[P]arties are generally free to structure their arbitration agreements as they see fit. Just as they may limit by contract the issues which they will arbitrate, so too may they specify by

contract the rules under which the arbitration will be conducted." *Volt Info. Scis., Inc. v. Bd. of Trustees of the Leland Stanford Junior Univ.*, 489 U.S. 468, 478 (1989) (citations omitted). "The Federal Arbitration Act 'requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms.'" *Western Employers Ins. Co. v. Jefferies & Co.*, 958 F.2d 258, 261 (9th Cir. 1992) (quoting *Volt Info. Scis.*, 489 U.S. at 478).

Given the requirement that courts give effect to the specific terms of arbitration agreements, courts have given effect to various contractual terms that limit the scope of an arbitrator's power. For example, in *Farkar Co. v. R. A. Hanson DISC, Ltd.*, 583 F.2d 68, 71 (2d Cir. 1978), the court held that a limitation of liability provision set forth as a separate clause from the arbitration provision prevented the arbitrators from awarding damages excluded by the liability limitation. Likewise, in *National Iranian Oil Co. v. Ashland Oil, Inc.*, 817 F.2d 326, 334 (5th Cir. 1987), the court held that a separate forum selection clause was not divisible from an arbitration agreement.

Here, the fact that the Dealer Agreement provides for arbitration of "all disputes" indicates that the damages limitation must be read as a term of the arbitration agreement, rather than a separate, divisible provision that was set aside along with the rest of the contract. The surviving arbitration provision must be interpreted in light of all contractual provisions pertaining to the arbitrators'

power. Accordingly, the fact that the Panel purported to set aside the contract had no effect on the unavailability of lost profit damages.

Defendants dispute this conclusion, arguing that the damages limitation applies only to actions in contract rather than tort. Because an action for fraud sounds in tort rather than contract, defendants claim, the damages provision is inapplicable. This assertion is incorrect. The damages limitation applies to "any matter arising out of, about, or pertaining to the subject matter of this agreement." Levitt Dec., Exhs. 42 at 3920 & 43 at 3933 (emphasis added). Courts have held that this type of language in the context of arbitration provisions extends to tort claims as well as contract claims. *See, e.g. Tate v. Saratoga Sav. & Loan Ass'n*, 216 Cal. App. 3d 843, 855 (1989) (interpreting the phrase "arising out of or relating to [this Agreement]" as encompassing "tort, as well as contractual, liabilities so long as the tort claims have their roots in the relationship between the parties which was created by the contract") (internal quotations omitted); *Chiron Corp. v. Ortho Diagnostic Sys., Inc.*, 207 F.3d 1126, 1131 (9th Cir. 2000) (interpreting the phrase "Any dispute, controversy or claim arising out of or relating to the validity, construction, enforceability or performance of this Agreement" as "broad and far reaching"); *Britton v. Co-op Banking Group*, 4 F.3d 742, 745 (9th Cir. 1993) (holding that such language is "routinely used in many securities and labor agreements to secure the broadest possible arbitration coverage"). Because the

damages limitation is to be interpreted in conjunction with the arbitration provision, the use of this broad language extends to fraud claims. Accordingly, if the damages limitation is valid, it remained operative during the arbitration, and the award of lost profits would have exceeded the Panel's authority. The court now turns to the question of whether the damages limitation is valid.

2. Validity

Defendants claim that the damages limitation is invalid under California law to the extent that it purports to exempt plaintiffs from liability for fraud. California Civil Code section 1668 provides: "All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law." In light of this provision, "contractual releases of future liability for fraud and other intentional wrongs are invariably invalidated." *Farnham v. Super. Ct.*, 60 Cal. App. 4th 69, 71 (1997). However, "contractual releases of future liability for ordinary negligence, as well as contractual indemnity provisions, insurance contracts, and other limitations on liability are generally enforceable." *Id.*; *see also McQuirk v. Donnelley*, 189 F.3d 793, 796-97 ("*Farnham* thus stands for the proposition that § 1668 invalidates the total release of future liability for intentional wrongs.").

It appears, therefore, that a limitation on fraud liability, rather than a full exemption, would be valid under California law. The available caselaw, however, is manifestly unclear on this point. The Court of Appeal in *Farnham*, 60 Cal. App. 4th at 71, addressed the validity of a contractual provision which included a waiver of any rights to bring a suit for damages against any shareholder, director, officer, or employee of a company, but allowed for suits against the company itself. The court hinted at a dichotomy between full exemptions and qualified limitations when it framed the question of the validity of the contractual waiver as "whether Farnham's retention of his rights against [the company] permits us to view his waiver of his claims against [shareholders, officers and directors] as a *limitation* on liability rather than as a complete exemption from *all* liability." *Id.*, at 75 (emphasis in original). The court upheld the provision, stating that although the plaintiff may have been able to show that he had not been fully compensated for his injuries by the company, the fact that he "retain[ed] his right to seek redress from the corporation" rendered the "contractual *limitation* on the liability of directors for defamation" valid under Section 1668. *Id.* at 76-77 (emphasis in original).

However, the court explicitly stated that its analysis was limited to the particular cause of action at hand – defamation – and that the court "express[ed] no view about the validity of the 'sole remedy' provision if Farnham's claim alleged fraud or

some other intentional tort." *Id.* at 77 n.7. The court then noted "the existence of a line of cases based on various kinds of alarm company limitations on liability," and that "such provisions are sometimes upheld as to intentional torts as well as negligence and gross negligence, but not as to fraud." *Id.* This suggests that fraud is set aside as warranting special consideration when assessing the validity of contractual limitations of liability.

Nonetheless, the parties point to no California authority, and the court has found none, squarely applying this framework to the type of damages limitation at issue here.[11] The court is mindful of the fact that, under California law, "Section 1668 is not strictly applied," *id.* at 74, and is therefore hesitant to hold that a contractual provision which merely excludes certain *types* of damages from fraud liability falls within the class of *exemptions* prohibited by Section 1668.

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[11] Defendants chiefly rely on *Ting v. AT & T*, 182 F. Supp. 2d 902, 924-25 (N.D. Cal. 2002) (Zimmerman, J.), *aff'd in part, rev'd in part*, 319 F.3d 1126 (9th Cir. 2003), in which Judge Zimmerman held that a similar limitation of liability was invalid under Section 1668. Judge Zimmerman's analysis, however, was directed principally at whether the provision at issue applied under the circumstances, and there is no discussion of the distinction between exemptions and limitations under California law. Furthermore, the Ninth Circuit did not reach the Section 1668 holding on appeal. *See Ting*, 319 F.3d at 1149 n.13. Because *Ting* is not a California case, and because much of the core analysis is inapplicable, the court declines to adopt the holding in that case regarding Section 1668.

In sum, the damages limitation provision was a valid circumscription of the Panel's authority, which remained operative as part of the valid arbitration agreement. Because the Panel's award of lost profits was barred by the damages limitation, the Panel exceeded its authority. The Final Award must therefore be vacated at least as to the award of lost profits.[12]

C. Non-Neutral Arbitrator Fees

The Final Award included $200,000 for Morganroth's non-neutral arbitrator fees assessed against plaintiffs. Final Award at 16. Plaintiffs assert that this award exceeded the Panel's authority and violated the Commercial Arbitration Rules. The majority cited only AAA Rule R-43 in support of this

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[12] As an additional attack on defendants' Section 1668 argument, plaintiffs claim that Section 1668 is preempted by the FAA. Because the court finds that Section 1668 is inapplicable, the court need not reach this issue. However, Judge Chesney in this district has squarely held that Section 1668 is not preempted by the FAA. *Winig v. Cingular Wireless LLC*, No. C 06 4297 MMC, 2006 WL 2766007, at *6-7 (N.D. Cal. Sept. 27, 2006) (Chesney, J.). Although the specific basis for unconscionability in that case was California's prohibition on certain waivers of class action rights, the court reached its holding based on its conclusion that the class action waiver was an "exemption of the party 'from responsibility for [its] own fraud, or willful injury to the person or property of another.'" *Id.* at *4 (quoting Cal. Civ. Code § 1668)). Because the prohibitions embodied in Section 1668 apply to all contracts, rather than to arbitration agreements only, Section 1668 is not preempted by the FAA.

award. Rule R-43(c) provides: "In the final award, the arbitrator shall assess the fees, expenses, and compensation provided in Sections R-49, R-50, and R-51. The arbitrator may apportion such fees, expenses, and compensation among the parties in such amounts as the arbitrator determines is appropriate." The arbitrator's ability to apportion fees, expenses, and compensation is therefore limited to "*such* fees, expenses, and compensation" provided in Sections R-49, R-50 and R-51 (emphasis added). Of these three rules, only Rule R-51 deals with arbitrator compensation, and it deals only with the compensation of the neutral arbitrator. Under the doctrine of *expressio unius est exlusio alterius*, "'[w]hen a statute limits a thing to be done in a particular mode, it includes a negative of any other mode.'" *Longview Fibre Co. v. Rasmussen*, 980 F.2d 1307, 1312-1313 (9th Cir. 1992) (quoting *Raleigh & Gaston Ry. Co. v. Reid*, 80 U.S. (13 Wall.) 269, 270 (1871)). In light of this doctrine, it would be improper to interpret the AAA Rules to implicitly allow for allocation of non-neutral arbitrator compensation when the text of the rules provides for allocation only of neutral arbitrator compensation. Accordingly, the court finds that the Panel lacked authority to shift Morganroth's fees to plaintiffs, and that portion of the final award must be set aside.

D. Timeliness of Award

Plaintiffs claim that the award was not issued within the time prescribed by the AAA rules, and is

therefore null. AAA Rule R-41 provides that "[t]he award shall be made promptly by the arbitrator and, unless otherwise agreed by the parties or specified by law, no later than 30 days from the date of closing the hearing. . . ." Based on a "draft order" submitted by AAA on August 22, 2006, the matter was deemed submitted "on or about September 5, 2006," and the final award would issue "on or before October 6, 2006." Levitt Dec., Exh. 1C at 150. By letter dated October 7, 2006, plaintiffs' counsel informed the three arbitrators that they had not received an award on or before October 6, 2007, that the Panel no longer possessed jurisdiction to issue an award, and that "any award which the Panel purports to issue on or after this date is a legal nullity." *Id.*, Exh. 1D. Three days later, plaintiffs' counsel sent another letter to the three arbitrators informing them that a final award had still not issued, and reiterating their position that the Panel had lost all jurisdiction. *Id.*, Exh. 1E. Plaintiffs' counsel sent a similar letter to the Vice President of AAA's Western Case Management Center. *Id.* The Final Award itself was transmitted by fax to counsel for both parties on October 10, 2006. *Id.*, Exh. 1. Grossman and Morganroth's signatures are both dated October 4, 2006, while Chernick's signature is dated October 6.

California law provides that an arbitration award "shall be made within the time fixed therefor by the agreement. . . ." Cal. Civ. Proc. Code § 1283.8. Here, the parties' agreement incorporates the AAA rules, which require that an award be "made" within 30

days of the close of hearing. AAA Commercial Arbitration Rules § R-41. The California Court of Appeal has held that, where a contract provides for the time within which an arbitration award is to be issued, "an arbitrator loses jurisdiction if a timely award is not forthcoming." *Baar v. Tigerman*, 140 Cal. App. 3d 979, 985 (1983) (superseded by statute on other grounds).

While plaintiffs acknowledge that all three arbitrators apparently signed their respective opinions by October 6, they assert that the signature date is irrelevant because the California Code provides for waiver of objections based on untimeliness "unless he gives the arbitrators written notice of his objection prior to the service of a signed copy of the award on him." Cal. Civ. Proc. Code § 1283.8. *See also Rusnak v. Gen. Controls Co.*, 183 Cal. App. 2d 583, 584-85 (1960) (holding that where the award was signed by the arbitrator within the time provided by the agreement but was not delivered until such time had expired, the award was null).

Other federal courts addressing the timeliness of arbitration awards have applied the applicable state law provisions. *See, e.g., Hasbro, Inc. v. Catalyst USA, Inc.*, 367 F.3d 689, 692-93 (7th Cir. 2004) (applying Wisconsin law and finding that failure to abide by the 30-day provision in AAA rules did not nullify the award because time was not of the essence); *Success Vill. Apartments, Inc. v. Amalgamated Local 376, Int'l Union United Auto. Aerospace & Agric. Implement Workers of Am., UAW*, 380 F. Supp. 2d 95, 98 (D.

Conn. 2005) (finding that failure to issue a timely award as required by a Connecticut regulation did not render the award invalid where there was no prior objection to the delay and no showing of actual harm resulting from the delay). Although other courts have applied varying standards to determine whether an untimely award is necessarily void, California courts have interpreted the rule strictly, recognizing that "the provisions of an agreement requiring the arbiter to render an award within a specified period are mandatory and jurisdictional and that an award rendered after the time has expired is a nullity and must be vacated by the court upon proper application." *Bosworth v. Whitmore*, 135 Cal. App. 4th 536, 550 n.12 (2006) (quoting *Rusnak*, 183 Cal. App. 2d at 584)). Furthermore, it is the delivery of the award, not the signing thereof by the arbitrators, that constitutes an award having been "made." *See Oats v. Oats*, 148 Cal. App. 3d 416, 420-21 (1983).

Defendants raise four arguments in defense of the timeliness of the award. First, defendants assert that the majority final award is dated October 4, 2006, and is therefore timely. As discussed above, however, the date of the award itself is irrelevant where the award is not transmitted to the parties within the specified time period.

Second, defendants claim that the California Code is inapplicable because the time of the award was not fixed by agreement of the parties, but by the Arbitration Panel members themselves. This assertion, even if true, is irrelevant. Under the Code, "[t]he

award shall be made within the time fixed therefor by the agreement or, if not so fixed, within such time as the court orders on petition of a party to the arbitration." Cal. Civ. Proc. Code § 1283.8. The Panel therefore was not empowered to set a deadline other than one agreed upon by the parties or ordered by a court. The Dealer Agreements state that "the proceedings shall be conducted in accordance with the Commercial Arbitration Rules of the American Arbitration Association," Levitt Dec., Exhs. 42 at 3920 & 43 at 3934, indicating that the Dealer Agreements incorporated Rule R-41. The Panel's authority therefore expired on October 5, 2006 (not October 6 as the draft order stated). All plaintiffs were required to do in order to invoke this deadline was to "give[ ] the arbitrators written notice of [their] objection prior to the service of a signed copy of the award on [them]." *Id.*

Third, defendants assert that plaintiffs' objection is barred by the fact that it was raised and considered by AAA and the Panel. Because this is a jurisdictional challenge, this court's analysis is without deference to the Panel's decision. Accordingly, this is not a valid defense to plaintiffs' timeliness argument.

Finally, defendants argue that plaintiffs' non-neutral arbitrator is the only arbitrator to sign his opinion after October 4, and that defendants should therefore not suffer the results of tardiness brought about by Chernick's delay. The additional delay brought about by Chernick is significant in light of the fact that the deadline was October 5, and the

majority opinion was signed on October 4. Presumably, the Panel would have issued the Final Award on October 4 or October 5 if Chernick had not waited until October 6 to sign his opinion. In light of the hypertechnical nature of plaintiffs' argument regarding the jurisdictional deadline, the court must be rigid in all respects. Vacating the award on this basis would effectively allow the dissenting Panel member to void the Final Award by delaying his own signature. Such a result is unacceptable.

Accordingly, the court rejects plaintiff's claim that the award should be vacated based on Section 1283.8.

II. Denial of a Hearing

Plaintiffs assert that, with respect to its determination that TKC was liable for fraudulent concealment, the majority improperly relied on evidence and claims from the Second Amended Claim despite having ruled that the First Amended Claim was the operative pleading. Chernick's discussion of the issue, which plaintiffs incorporate into their motion, is as follows:

> The parties and the Panel also consistently treated the pleadings as determinative of the Tribunal's power. For example, the motions to dismiss resolved some claims and were intended to define what was and what was not in dispute in this proceeding; also, the claims for attorneys' fees by both sides contained in their pleadings provides the

> only basis for the Tribunal to award such fees (*see* Interim Award at 12). Finally, Claimants sought sanctions against Respondents for abuses of the discovery process. The Tribunal sought to enforce the parties' discovery rights and the Majority granted Claimants' motion (Interim Award at ¶ 3-4).
>
> The Majority should have treated the issue of the proposed Second Amended Claim in the same fashion. Instead, it relied on evidence that was not the subject of the Claims Notification Process; not disclosed by a pleading that was permitted to be filed in this case; and that was never tested by discovery. Respondents were unable to offer opposing evidence during the hearing and were not permitted to reopen to offer such evidence when it was later discovered after the close of the hearing.

Final Award, Chernick Dissent at 7.

Defendants make no response to this argument other than stating that it falls "under the province of the arbitrator's discretion," and is therefore not subject to review. Opp. at 34. This is plainly incorrect, as arbitrators do not have discretion to "refus[e] to hear evidence pertinent and material to the controversy." 9 U.S.C. § 10(a)(4). When relevant evidence is excluded, a federal court may vacate an arbitration award where the exclusion of such evidence "so affects the rights of a party that it may be said that he was deprived of a fair hearing." *Hoteles Condado Beach, La Concha & Convention Ctr. v. Union de*

Tronquistas Local 901, 763 F.2d 34, 40 (1st Cir. 1985) (internal quotation omitted).

Reviewing the Final Award, much of the factual basis for plaintiffs' fraud liability (the sole claim on which defendants were awarded damages), stems from conduct alleged only in the SAC. The majority discussed plaintiffs' failure to advise defendants of the "inherent risk involved in becoming an art gallery owner" beyond the specific risks associated with competing with other Thomas Kinkade galleries. Final Award at 9; SAC ¶¶ 31-32. Additionally, the majority devotes substantial discussion to plaintiffs' presentation of financial information related to the Signature Gallery program, and plaintiffs' failure to inform defendants of the changed financial conditions of TKC and other Signature Gallery dealers during the time between the initial presentation of financial information and the execution of the first Dealer Agreement. Final Award at 9. These allegations appear in the SAC, but nowhere in the FAC. SAC ¶¶ 33-34, 42. While there were other bases for fraud liability that were pled both in the FAC and SAC, the majority improperly relied on allegations and evidence related to a pleading that the Panel had explicitly rejected, without affording plaintiffs an opportunity to conduct discovery or present evidence in rebuttal. This is plainly at odds with the requirements of the FAA, and warrants vacatur of the award.

III. Undue Means or Fraud

As used in the FAA, "undue means" "clearly connotes behavior that is immoral if not illegal." *A.G. Edwards & Sons, Inc. v. McCollough*, 967 F.2d 1401, 1403 (9th Cir. 1992) (per curiam). Furthermore, "the statute requires a showing that the undue means caused the award to be given." *Id.* In other words, the party seeking vacatur must show that the arbitrators relied on the fraud or undue means in reaching the award. *Id.*

Plaintiffs allege numerous instances of misconduct on the part of the Yatooma firm related to the final award. With the exception of the attorneys' fee application, which the court will consider in a separate order, each alleged instance appears to have been presented to and considered by the Panel during the proceeding. The Panel sanctioned the Yatooma firm four times, and the Final Award indicates that the damage award has been adjusted based on counsel's misconduct. Final Award at 13. The Final Award also states that the majority all but disregarded the testimony of Sheppard. *Id.* at 11. Allegations of fraud and undue means which are presented to and considered by the Arbitration Panel cannot support vacatur of the arbitration award. *A.G. Edwards & Sons*, 967 F.2d at 1404 (holding that "where the fraud or undue means is not only discoverable, but discovered and brought to the attention of the arbitrators, a disappointed party will not be given a second bite at the apple"); *see also Kotakis v. Gruntal & Co.*, No. C 97-0202 CRB, 2000

WL 1006541, at *4 (N.D. Cal. July 11, 2000) (Breyer, J.) (holding that the examples of fraud and undue means that had been presented to the arbitrators could not support an order vacating the arbitration award). Accordingly, apart from allegations related to defendants' application for fees and costs, the court does not find that the award was procured by fraud or undue means.

IV. Arbitrator Bias and Corruption

"Evident partiality" has been shown in cases of nondisclosure and in cases of actual bias. *Woods v. Saturn Distribution Corp.*, 78 F.3d 424, 427 (9th Cir. 1996). In the former case, vacatur is appropriate where the arbitrator's failure to disclose information gives rise to a "reasonable impression" of bias in favor of one party. *Id.* If such a reasonable impression is made, the faultiness of the arbitrator's decision itself is not necessarily relevant because the failure to disclose facts infects the proceeding itself. *Id.* On the other hand, a party alleging actual bias must "establish specific facts which indicate improper motives." *Id.* "'The appearance of impropriety, standing alone, is insufficient' to establish evident partiality in actual bias cases." *Id.* (quoting *Sheet Metal Workers Int'l Ass'n Local Union No. 420 v. Kinney Air Conditioning Co.*, 756 F.2d 742, 746 (9th Cir. 1985) (hereinafter *Kinney*)). Although there is little guidance as to what "specific facts" suffice to show evident partiality, "[e]ven repeated rulings against one party will not establish bias absent some

evidence of improper motive." *Kinney*, 756 F.2d at 746; *see also Nordahl Dev. Corp. v. Salomon Smith Barney*, 309 F. Supp. 2d 1257, 1267 (D. Or. 2004).

A. Grossman

The centerpiece of plaintiffs' attack on Grossman's neutrality is the alleged hug and kiss that Grossman gave to Hazlewood following the fee application hearing. Defendants can neither deny nor confirm that the affectionate actions took place, but merely dispute their significance assuming they did occur. Defendants claim that the alleged conduct was so brief that it went unnoticed by everyone in the room except plaintiffs' counsel and his two assistants.

Plaintiffs claim that Grossman's bias, as evidenced by the hug and kiss, played itself out in numerous adverse rulings and other actions throughout the proceeding. Specifically, plaintiffs fault Grossman with the following conduct: abruptly changing the time rules in the middle of the arbitration to plaintiffs' prejudice, and responding flippantly to plaintiffs' counsel's objection (Levitt Dec. ¶¶ 76-86); asking easy questions to Hazlewood during her rebuttal testimony, allegedly "designed to rehabilitate her struggling testimony" (*Id.* ¶ 110); repeated failure to effectively sanction defense counsel for its "persistent misconduct"; and denying plaintiffs discovery and a hearing regarding Morganroth's fee request (Final Award, Chernick Dissent at 11). Furthermore, plaintiffs claim that

Grossman was poisoned against plaintiffs by Morganroth as a result of the two men's hastily formed friendship and repeated lunch outings.

Before assessing Grossman's alleged bias, it is necessary to determine whether plaintiffs' bias claim regarding Grossman is timely. Defendants note that the hug and kiss purportedly occurred on August 1, 2006, over two months before the final award was issued, Levitt Dec. ¶ 12, but that plaintiffs never objected or mentioned this conduct before bringing the instant motion. In addition, the declarations of two [sic] the percipient witnesses are each dated in August 2006. André Dec.; Zorina Dec. "By failing to object to the arbitrator proceeding as arbitrator, and continuing to participate in the hearing after the arbitrator's full disclosure," a party waives any claim that the resulting award should be set aside as a result of alleged arbitrator bias or corruption. *Theis Research, Inc. v. Brown & Bain*, 400 F.3d 659, 666 (9th Cir. 2005); *see also Delta Mine Holding Co. v. AFC Coal Props., Inc.*, 280 F.3d 815, 821 (8th Cir. 2001) ("Even when a neutral arbitrator is challenged for evident partiality, the issue is deemed waived unless the objecting party raised it to the arbitration panel.").

Plaintiffs raise two responses to defendants' waiver argument. First, plaintiffs make the unsupported suggestion that waiver of objection to a non-neutral arbitrator is only applicable in non-disclosure, rather than actual bias, cases. Second, plaintiffs claim that the alleged hug and kiss took

place months after the majority had made a finding of liability, and that objecting to Grossman at that point would have been pointless. Assuming that attempting to disqualify Grossman in August 2006 would not have resulted in re-litigating the entire proceeding, plaintiffs are correct that little would have been gained by objecting to Grossman at that point. The damage, if any, had been done. Accordingly, plaintiffs did not waive their right to challenge Grossman's neutrality by failing to object during the proceedings.

The court nonetheless finds that plaintiffs have failed to make a sufficient showing of actual bias on the part of Grossman. Plaintiffs point to several instances where Grossman's conduct was adverse to plaintiffs during the extensive arbitration proceeding. These alone are insufficient to show bias. Plaintiffs' one piece of extrinsic evidence is the hug and kiss which, while questionable, does not rise to the level of bias supporting vacatur. Instances of evident partiality typically involve concrete financial interests or established, ongoing relationships. The Supreme Court in *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 145, 149-150 (1968), on which plaintiffs rely, stated that an arbitrator "should, however, in pending or prospective litigation before him be particularly careful to avoid such action as may reasonably tend to awaken the suspicion that his *social or business relations or friendships*, constitute an element in influencing his judicial conduct" (emphasis added). Here, there is no evidence, or allegation, of an actual relationship between

Grossman and Hazlewood. Plaintiffs have therefore failed to demonstrate evident partiality on the part of Grossman.

B. Morganroth

Plaintiffs claim that Morganroth failed to disclose the fact that defendants had not paid him in full. From this premise, plaintiffs leap to the conclusion that Morganroth was operating on a *de facto* contingency basis, that he knew he would not be paid unless defendants "won and won big," and that the failure to disclose this arrangement created the impression of bias. This argument would create a per se requirement that non-neutral arbitrators be paid up-front. Plaintiffs point to no authority for this rule and the court declines to adopt one now. Even if Morganroth might not have been paid absent a substantial cash award in favor of defendants, he would still be *owed* the balance of his fees regardless of the outcome of the arbitration. Plaintiffs' attempt to shoehorn this situation into an undisclosed contingency fee arrangement is unavailing.[13] *See Barcume v. City of Flint*, 132 F. Supp. 2d 549, 557 (E.D. Mich. 2001) (holding that the defendant's argument that "because Plaintiffs owed [the]

[13] Of course, Morganroth clearly had a financial interest in the majority's decision to allocate $200,000 of Morganroth's compensation to plaintiffs. This portion of the award was invalid under the AAA rules, but did not affect the remaining aspects of the final award.

Arbitrator . . . her fees for some time, that unduly influenced her to render a decision in their favor" was "not enough for a reasonable person to conclude that an Arbitrator was partial to one party to the arbitration").

Plaintiffs further allege that Morganroth violated Canon X by failing to "act in good faith and with integrity and fairness." Specifically, plaintiffs assert that Morganroth (1) falsely accused TKC's counsel of criminal conduct, (2) repeatedly interrupted counsel in a rude and aggressive way, (3) "beat up on TKC's witnesses," including interrupting and badgering TKC's Chief Financial Officer, and (4) interjected false claims about events in the White arbitration, including falsely implying that the White Arbitration Panel had found TKC and its counsel liable for discovery abuses. Levitt Dec. ¶¶ 96-107. To begin with, courts have held that violations of Ethical Canons do not constitute grounds for vacating an arbitration award. *See Delta Mine Holding Co.*, 280 F.3d at 820 ("It is well-settled that only the statutory grounds in § 10(a) of the Act justify vacating an award; arbitration rules and ethical codes do not have the force of law.") (internal quotations omitted). Furthermore, in terms of partiality, the standards applicable to non-neutral arbitrators do not necessarily apply to party-appointed arbitrators because "the main party-appointed arbitrators are *supposed* to be advocates." *Sphere Drake Ins. Ltd. v. All Am. Life Ins. Co.*, 307 F.3d 617, 620 (7th Cir. 2002) (emphasis in original); *see also Delta Mine Holding*

Co., 280 F.3d at 821 (rejecting the claim that "general statutory language, calling for the arbitrators to be impartial should be interpreted as refusing enforcement to the awards of arbitrations in which the parties contract for partisanship"). Morganroth's conduct during the proceeding therefore does not rise to the level of evident partiality or corruption sufficient to vacate an arbitration award.

V. Complete Disregard for the Law

Federal Courts of Appeals have repeatedly held that "'[m]anifest disregard of the law' means something more than just an error in the law or a failure on the part of the arbitrators to understand or apply the law. It must be clear from the record that the arbitrators recognized the applicable law and then ignored it." *See Carter v. Health Net of Cal., Inc.*, 374 F.3d 830, 838 (9th Cir. 2004) (discussing cases). Plaintiffs assert that the Panel manifestly disregarded clear California law in three respects: first, plaintiffs claim that the evidence is uncontradicted that defendants' fraud claims were barred by the statute of limitations; second, plaintiffs claim that Spinello's allegedly concealed bankruptcy clearly afforded plaintiffs a complete defense to Spinello's fraud claim based on the doctrine of unclean hands; third, plaintiffs claim that the Panel's award of damages was inconsistent with its finding that the Dealer Agreement had been rescinded.

A. Statute of Limitations and Unclean Hands

With respect to the statute of limitations and unclean hands defenses, plaintiffs point to nothing in the record showing that the arbitrators knew the applicable law and ignored it, as opposed to merely making errors of fact or law. With regard to the statute of limitations issue, in particular, the majority stated as follows:

> There was discussion by Respondents relating to the statute of limitations with regard to the fraud allegations. The Majority finds that the significant failures of disclosure – that is, the omissions – such as the change in fortune of both the corporate stores and many signature dealers – [sic] did not come to light in many instances until the discovery phase of this arbitration. Thus, such omissions allow for delayed discovery by Claimants which is certainly reasonable and tolls any statute of limitations. Accordingly, with regard to the fraud claim, the statute did not expire based on the evidence with regard to the claim for fraud in the inducement.

Final Award at 10. This certainly may have been an incorrect application of law (the record is unclear), but it does not show that the majority willfully ignored the law, as required to vacate an award.[14]

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[14] Chernick dissented on the statute of limitations issue, but acknowledged that this point "goes to the sufficiency of the evidence and constitutes an assertion of legal or factual error

(Continued on following page)

Accordingly, plaintiffs have failed to show manifest disregard for the law regarding the statute of limitations and unclean hands.

B. Damages

In their supplemental briefing, plaintiffs and defendants disagree as to whether the Panel properly awarded consequential damages after setting aside the Dealer Agreement. Plaintiffs assert that, because rescission is meant to put the rescinding party in the *status quo ante*, consequential damages are unavailable following rescission because such damages presume the existence of a contract.

Defendants, meanwhile, argue that California's statutory provisions regarding rescission provide for complete relief including consequential damages. The California Civil Code provides:

> A claim for damages is not inconsistent with a claim for relief based upon rescission. The aggrieved party shall be awarded complete relief, including restitution of benefits, if any, conferred by him as a result of the transaction *and any consequential damages to which he is entitled*; but such relief shall not include duplicate or inconsistent items of recovery.

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which . . . may or may not be considered by a reviewing court under the Ninth Circuit's interpretation of the Federal Arbitration Act." Final Award, Chernick Dissent at 8.

Cal. Civ. Code § 1692 (emphasis added). In *Runyan v. Pac. Air Indus., Inc.*, 2 Cal. 3d 304, 319 (1970), following a lengthy discussion of California rescission law before and after the enactment of Section 1692 [sic], determined that "loss of income" damages were properly awarded following the rescission of a contract. The court held that Section 1692 allowed a rescinding party to recover "original consideration and the damages he sustained in reliance on the contract." *Id.* The Panel's award of consequential damages after setting aside the contract therefore appears to be squarely consistent with California law, and at the very least does not amount to a manifest disregard for the law. Accordingly, the award need not be vacated on these grounds.

VI. Rationality of Damage Award

Plaintiffs claim that the majority's calculation of damages was "completely irrational" and must be thrown out. The only evidence that the Panel heard on the issue of damages was testimony from defendants' damages expert. The majority ultimately awarded damages based on the expert's testimony, finding "some merit" in the testimony but applying "a significant discount" to the expert's estimate due to various doubts about the estimate's reliability. Final Award at 11-12. Plaintiffs assert that this amounts to the majority having "picked a number out of thin air," and that the award was therefore speculative and irrational. While the majority's methodology is neither clear or perfect, it is not "completely

irrational." Having no evidence other than the expert's testimony, but finding some problems with the expert's credibility, the majority adjusted the estimate downward by a substantial amount. This is not a completely irrational approach to determining the appropriate damage award.

VII. Further Issues to Be Resolved

The parties have separately briefed the issue of whether the Panel's award of attorneys' fees to defendants should be vacated based on alleged fraudulent conduct on the part of defense counsel. The motion to vacate the award of attorneys' fees is currently under submission. The parties are hereby ordered to submit supplemental briefs directed to the sole question of what effect, if any, vacatur of the arbitration award has on the Panel's award of attorneys' fees. On or before June 20, 2007, each party shall submit its supplemental brief, not to exceed eight pages.

CONCLUSION

The court has determined that the portions of the arbitration award consisting of non-neutral arbitrator fees and lost profits must be vacated. The court has further determined that the award was improperly based on the Second Amended Claim, and that plaintiffs were deprived of a fair hearing on the evidentiary issues giving rise to the award. Although the court has ruled in favor of defendants on certain

other grounds for vacatur, the court's holding regarding the denial of a hearing warrants vacatur of the entire award.

For the reasons stated above, the court GRANTS plaintiffs' motion to vacate the arbitration award. The parties are ORDERED to submit further briefs directed to the sole question of what effect, if any, vacatur of the arbitration award has on the Panel's award of attorneys' fees, not to exceed eight pages, on or before June 20, 2007.

IT IS SO ORDERED.

Dated: June 5, 2007

/s/ Marilyn Hall Patel
MARILYN HALL PATEL
United States District Court Judge
Northern District of California

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

THE THOMAS KINKADE COMPANY, f/k/a MEDIA ARTS GROUP, INC., a California corporation and RICHARD F. BARNETT,

Plaintiffs,

v.

KAREN HAZLEWOOD, JEFF SPINELLO, and THOMAS KINKADE AT THE DOWNTOWN MALL, LLC, a Virginia Corporation,

Defendants.
/

No. C 06 7034 MHP

MEMORANDUM & ORDER

Re: Plaintiffs' Motion to Vacate Award of Attorneys' Fees and Costs and Request for Attorneys' Fees

(Filed Jul. 18, 2007)

Plaintiffs The Thomas Kinkade Company ("TKC") and Richard F. Barnett (collectively "plaintiffs") have appealed an arbitration award issued in favor of Karen Hazlewood, Jeff Spinello (together, "the Hazlewoods") and Thomas Kinkade at the Downtown Mall, LLC (collectively "defendants") in October 2006. Plaintiffs have previously moved to vacate the substantive portion of the arbitration award, and now move to vacate the award of attorneys' fees and costs. Additionally, plaintiffs seek an award of their own attorneys' fees. Having considered the arguments of the parties and for the reasons set forth below, the court enters the following memorandum and order.

BACKGROUND[1]

The background of the dispute between plaintiffs and defendants is set forth in this court's previous order, [CITATION]. The action before this court arises from an arbitration award issued in favor of defendants in October 2006. The Arbitration Panel ("the Panel") consisted of three arbitrators, and the Final Award was issued by a 2-1 vote. In addition to awarding $860,000 in damages, the Majority added $900,000 in attorneys' fees and costs. The panel also allocated $200,000 of defendants' non-neutral arbitrator compensation to be paid by plaintiffs, and included awards of administrative fees, witness fees, and an allocation of the neutral arbitrator's compensation. Plaintiffs now move to vacate the award of attorneys' fees and costs on the grounds that the award was procured by fraud on the part of defense counsel ("the Yatooma Firm"). The relevant facts related to the award of attorneys' fees and costs are set forth below.

1. The Arbitration Proceeding

The Panel determined in February 2005 that defendants were the prevailing party in the arbitration, and directed defendants to file an application for attorneys' fees and costs. The following month,

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[1] Unless otherwise indicated, the background facts are taken from the parties' submissions, declarations, and attachments thereto.

defendants filed a written request for attorneys' fees, costs, expenses and interest ("the Fee Application"), seeking more than $2.5 million in fees and costs. First Levitt Dec., Exh. 55. Although the Fee Application included bills and cost records, there were no declarations affirming the accuracy or authenticity of these supporting documents. *Id.*

In response to the Fee Application, plaintiffs requested that the panel allow them to conduct discovery related to defendants' purported fees and costs. Specifically, plaintiffs sought the production of written fee agreements, contemporaneous timesheets and pre-bills, and depositions of defendants, the person most knowledgeable at defense counsel's law firm and Norman Yatooma, the principal attorney at the Yatooma Firm regarding the preparation of the bills at issue. Second Levitt Dec. ¶ 47. While this request was pending, the panel ordered defendants to provide plaintiffs with "all documents pertaining to any fee and/or cost arrangement between Claimants or either of them and counsel for Claimants, together with an accompanying affidavit under penalty of perjury confirming that these documents constituted all of the binding agreements between the Claimants or either of them and Claimants' counsel." In response, defendants produced two fee agreements containing the following relevant provisions: first, that defendants agreed to pay an hourly rate of up to $425, and second, that all services performed after December 14, 2004 were to be billed on a pure contingency basis. First Levitt Dec., Exhs. 94-95.

In the meantime, defendants filed an opposition to plaintiffs' discovery request, claiming that gathering, redacting and producing several years' worth of timesheets would be unreasonably burdensome. First Levitt Dec., Exh. 96. The panel nonetheless granted plaintiffs' discovery request in essentially all respects. The following day, defendants filed a motion for reconsideration directed at the portion of the discovery order requiring the production of contemporaneous timesheets. The motion discussed at length the burdens that the timesheets requirement would impose on the firm, claiming that "[a]ssuming an average of seven staff members billing time to this matter since May 21, 2003, approximately . . . 5,845 distinct daily time sheets were created in the period from May 21, 2003 to the present date." First Levitt Dec., Exh. 97 at 3. The motion further stated that, if the Yatooma firm were [sic] devote four attorneys working ten hours per day to the "Herculean task" of producing the timesheets, it would take at least fifteen days to complete. *Id.*

The panel denied defendants' motion for reconsideration and once again ordered the production of contemporaneous timesheets. First Levitt Dec., Exh. 98. The Yatooma firm initially produced fewer than fifty pages of documents, and produced an additional 279 pages on the eve of one of the depositions ordered by the Panel. Second Levitt Dec. ¶ 57, Exhs. 14-15. The Yatooma firm did not produce any timesheets or pre-bills.

Plaintiffs then deposed Mr. Yatooma. Mr. Yatooma testified that all contemporaneous timesheets were deleted from the firm's computer as a matter of course, and that there was no written record of the time recorded by the attorneys in the arbitration except what had been attached to the Fee Application. First Levitt Dec., Exh. 89, Yatooma Dep. at 6-7. Mr. Yatooma further testified that the bills attached to the initial Fee Application were copies of what had been sent to defendants and were not "recreated after the fact." *Id.* at 16:20-22. The testimony of Sarah Smigels, the firm's office manager, was consistent with these claims, stating that she received time submissions via email or telephone, entered them into a time recording program called PC Law Jr., and then deleted the emails. First Levitt Dec, Exh. 92, Smigels Dep. at 25. The final arbitration award accepted these assertions, concluding that "[t]here are no contemporaneously created time sheets or pre-bills," but rather that "time was communicated by e-mail or tape to the office manager who transferred that time to billing statements and then erased the tapes and deleted the e-mails." First Levitt Dec., Exh. 1 at 13 (hereinafter "Final Award"). Lacking "reliable" evidentiary support for defendants' Fee Application, the panel made its own determination of "the reasonable fee based on the scope of the representation, the extent of the effort, the appropriate hourly rates for counsel and staff and other relevant factors, including the discussion of sanctions," and awarded $900,000 in attorneys' fees. *Id.* at 14. This award represented slightly more than one third of the approximately

$2.7 million that defendants ultimately requested, the amount having increased from the original $2.5 million during the course of the proceedings related to the fee request.

Plaintiffs subsequently brought this appeal pursuant to the Federal Arbitration Act, 9 U.S.C. sections 1 *et seq.* On January 8, 2007 plaintiffs moved for limited discovery related to defendants' attorneys' fees. This court granted plaintiffs' motion, and plaintiffs conducted discovery thereafter. *Thomas Kinkade Co. v. Hazlewood,* No. C 06 7034 MHP, 2007 WL 217384 (N.D. Cal. Jan. 25, 2007) (Patel, J.). According to plaintiffs, evidence obtained subsequent to the arbitration proceeding, as a result of this court's order and otherwise, establishes that the Yatooma Firm made misrepresentations to the Panel in support of their Fee Application that warrant vacatur.

Plaintiffs focus on five principal allegations of deceit on the part of defendants and defense counsel. First, plaintiffs claim that the Fee Application did not accurately reflect the amount of time defense counsel spent on behalf of defendants in the arbitration, and did not accurately reflect the dollar value of the fees that defendants had been billed or were obligated to pay. Second, plaintiffs assert that the Yatooma Firm improperly withheld critical documents, namely the contemporaneous timesheets, that would have demonstrated to the Panel that the Fee Application bills were inaccurate. Third, plaintiffs allege that Mr. Yatooma and Ms. Smigels committed perjury by testifying that contemporaneous timesheets had been

deleted in the ordinary course of business. Fourth, and relatedly, plaintiffs assert that Mr. Yatooma and Ms. Smigels committed further perjury when they represented that the Fee Application bills accurately reflected the amount of attorneys' fees incurred in the arbitration. Finally, plaintiffs claim that defense counsel committed billing fraud by seeking to recover attorneys' fees that had already been paid, or would be paid, by other clients of the firm who were also involved in litigation against the Media Arts Group. The evidence cited by the parties relevant to each allegation is discussed below.

II. Accuracy of Fee Application Bills

Plaintiffs claim that the bills submitted with the initial Fee Application were different from the bills actually sent to defendants. Second Levitt Dec. ¶¶ 71-75, 85-86, Exh. 18 at 2298-2329, Exhs. 25-26; First Levitt Dec., Exh. 55 at 4449-79, Exhs. 33 & 109. Exhibit 18 to the Second Levitt Declaration is apparently a set of "genuine" bills taken from the client file, and are consistent with the contemporaneous timesheets. However, these time entries are inconsistent with the bills submitted with the Fee Application. Second Levitt Dec. ¶¶ 25, 32, 81-82, Exh. 18 at 2298-2329. Plaintiff has prepared two charts setting forth the alleged discrepancies between the Fee Application bills and the authentic bills, as well as the allegation that portions of the claimed attorneys' fees had already been paid by other clients. Second Levitt Dec., Exhs. 25 & 26. Comparing the two documents

independent of the charts, there are numerous entries which are identical in terms of their date, description, and billing attorney, but with large discrepancies between the hours allocated on the two documents.

As one example of such a discrepancy, the first entry in the genuine bills is for 1.25 hours of work by attorney Joseph Ejbeh described as "Reviewed documents produced by Media Arts in preparation for depositions of Media Arts' witnesses." Second Levitt Dec., Exh. 18 at 2299. The Fee Application bills contain an identical entry except that the hour figure is given as 13.75, rather than 1.25. First Levitt Dec., Exh. 55 at 4449. Reviewing the first page of each set of bills, plaintiffs allege that six of the eight entries are multiplied by a factor of 7, 9, 11 or 15. In addition to the inconsistencies regarding the hours spent, plaintiffs further claim that Mr. Yatooma improperly requested an hourly rate of $425, when he actually charged a lower rate. Second Levitt Dec. ¶¶ 22, 23 & 43, Exhs. 2 & 9; First Levitt Dec., Exh. 55.

Defendants' explanation for the hour discrepancies is that the bills submitted to the arbitration panel included time for all Media Arts matters, while the bills sent to the Hazlewoods included only the time allocated to them. Defendants therefore admit that they sought reimbursement from the panel for Media Arts general time, but assert that the panel was fully aware of this. Because defendants admit the underlying factual allegation, the court must consider evidence related to whether the submission of

inconsistent bills to the Panel was proper. The pertinent issue, therefore, is whether this fact was discoverable and discovered during the underlying arbitration proceeding, or whether it was concealed from the arbitration panel by defendants and defense counsel.

A. Hearing Testimony

Defendants claim that the Panel was fully aware of their attempt to recover the full costs of services chargeable to Media Arts in general. During the Panel's hearing on defendants' Fee Application, Mr. Yatooma testified at length regarding the issue. To begin with, Mr. Yatooma testified that there was "no agreement among those clients," meaning defendants and the additional Media Arts clients, to share costs or expenses. Defs.' Exh. 7 at 8240:12-16. However, Mr. Yatooma further testified that he had arranged with plaintiffs' counsel to develop a consolidated discovery schedule so that Media Arts witnesses would not need to be deposed multiple times. *Id.* at 8240:17-8241:10. Mr. Yatooma was then asked whether it was "claimants' position that Media Arts, respondents in this case, should pay the full amount of those [consolidated] depositions," to which Mr. Yatooma responded "Yes." *Id.* at 8241:25-8242:3. Asked to explain this position, Mr. Yatooma testified as follows:

> Because the deposition was necessary, and it was necessary for this case, and it would have been necessary for this case even if I

> did not represent five other Media Arts claimants.
>
> And because we made this consolidated discovery effort in large part for the convenience of Mr. Levitt's clients, I don't believe that entitles Media Arts to a windfall, allowing them to pay one sixth of the discovery costs or at least those deposition costs or fees.
>
> Now, I certainly can't collect for the deposition of Ken Raasch more than once, that I full well understand, but if Media Arts is going to be required to pay fees because they have been found liable for fraud, they should pay fees for the entire discovery process.

Id. at 8242:5-20. From this exchange, the Panel at least knew that defendants were seeking attorneys' fees and costs beyond those specifically allocated to defendants.

Mr. Yatooma's explanation prompted Arbitrator Grossman to question him as to the allocation of fees and costs among Media Arts clients. Because the exchange was somewhat complicated, it is best to reproduce the relevant portion in its entirety rather than attempt to paraphrase the questions and answers:

> MR. GROSSMAN: What's your plan for the other cases? How will you charge them?

THE WITNESS: As Sarah [Smigels] described, Mr. Grossman, there are – these sorts of items are tracked under a Media Arts general billing code, and *the Media Arts general items have been billed in full on the Hazlewood matter.*

In the event that, for instance, there is a reimbursement to cover the deposition of Mr. Raasch, then the prorata share in sixths that has been applied otherwise to the other clients would be credited to them. If this is not -- if it is not reimbursed, then every client would then be caused to pay one sixth of that deposition.

MR. GROSSMAN: Let me understand that. Mrs. Hazlewood pays 100 percent and the other people – let's say there are five others or six others, they are each going – or five.

THE WITNESS: Six in total.

MR. GROSSMAN: Six in total. Each of them is going to pay their prorata share even if Mrs. Hazlewood has to pay it?

THE WITNESS: No.

MR. GROSSMAN: No. If she doesn't have to pay it, then you will allocate one sixth to each one?

THE WITNESS: That's right.

MR. GROSSMAN: And do the same thing. If case number two, someone for some reason gives you – reimburses you for those

> costs, then what, everybody is going to get credited?
>
> THE WITNESS: Well, if we are talking about the same depositions, those depositions would not be in a fee application for a second fraud award if they were reimbursed here.
>
> My point is that we can only collect one time for one deposition. That deposition, in its entirety, 100 percent of that deposition was necessary for this case, so 100 percent of that deposition is sought for reimbursement here in this case.
>
> *If 100 percent of that deposition is not reimbursed in this case, the balance of it will be billed accordingly to those clients that benefitted from that deposition.*
>
> I do not believe, however, that Media Arts should get the benefit of that windfall, the clients should.

Id. at 8243:5-8244:25 (emphasis added). The italicized language is fully consistent with what ultimately appears to have occurred. The Yatooma Firm billed all Media Arts general matters to the Hazlewood matter, hoping to receive a full recovery of attorneys' fees. The Fee Application bills contained time entries consistent with billing the Hazlewoods in full for all Media Arts general work. Because the Panel ultimately declined to award the full amount of fees requested, however, the Yatooma Firm re-allocated the costs among the Media Arts clients, resulting in

an altered bill for the Hazlewoods. Plaintiffs addressed the issue of fee allocation in their brief opposing the attorney fee award in the underlying arbitration, arguing that defendants were not entitled to recover the full costs of consolidated depositions. Defs.' Exh. 3 at 45.

In response, plaintiffs cite evidence indicating that the Panel was led to believe that only services for which the Hazlewoods were responsible were the subject of the Fee Application. While discussing one consolidation deposition, Mr. Grossman stated that "we have to understand that Mr. Levitt's clients aren't getting all the fees and then – all the expenses and all the fees for things that really there was an agreement to allocate between various other cases." Defs.' Exh. 7 at 8168:16-20. In response, Ms. Smigels testified that "there was no agreement between us and any of the clients, like 'Hey, we have a bunch of Media Arts cases, you guys all get to split the costs.'" *Id.* at 8168:21-24. Ms. Smigels also testified that the "Media Arts general" file was the Hazlewood file. *Id.* at 8167:9-11. Elaborating on the mechanics of this arrangement, Ms. Smigels had the following exchange with Mr. Grossman:

> MR. GROSSMAN: . . . All of Mr. Raasch's 12 hours get charged to the Hazlewood file.
>
> THE WITNESS: Right.
>
> MR. GROSSMAN: If you recover your costs –

THE WITNESS: Correct.

MR. GROSSMAN: – then the White people don't pay anything for that deposition, or do you rebill it to them?

THE WITNESS: No, we don't rebill, no. Then the cost would – I mean, we are not going to ask for it two or three times. That would be credited towards his invoice.

MR. GROSSMAN: And how do I know that Mr. – how do I know that it is fair to the Hazlewoods that it all be allocated to them? Because you would have had to do it anyway, is that your answer?

THE WITNESS: Right, yeah. I mean, if we didn't have any other Media Arts cases, we would have still had to do everything that we did.

Id. at 8169:1-19. Mr. Grossman's inquiry as to whether this arrangement was "fair to the Hazlewoods" suggests that Mr. Grossman understood the arrangement to be that the Hazlewoods would actually be charged for all Media Arts general fees and costs. Mr. Yatooma's subsequent testimony clarifying Smigel's statements, however, made it clear that the charges were being allocated to the Hazlewoods only for the purposes of the Fee Application, and that if the Fee Application was not successful the charges would be re-allocated.

B. Additional Representations by Defense Counsel

The briefs and discovery in the underlying arbitration further support the contention that defendants created the impression that the fees sought were those actually incurred by defendants. In their Fee Application, defendants stated that "Claimants became liable to pay for each service and for each cost." First Levitt Dec., Exh. 109 at 18. Additionally, Mr. Yatooma further testified that the bills submitted with the Fee Application – the bills which defendants now admit set forth charges that defendants were not responsible for – "accurately set forth the amount of costs and attorney fees *incurred by claimants in the prosecution of this case*." Defs.' Exh. 7 at 8266:4-16 (emphasis added). Mr. Yatooma additionally denied the existence of "any agreement applied between the claimants in this case and the claimants in any other case against Media Arts to share any costs or expenses of litigation." *Id.* at 8240:12-16. Finally, affidavits submitted by Mr. Yatooma and Ms. Smigels along with their Reply Brief in support of their Fee Application state that the attached bills (those setting forth all Media Arts charges) accurately reflect the charges incurred in working on the Hazlewood matter, not Media Arts matters in general. First Levitt Dec., Exh. 109 at Exhs. 11 ¶ 21 & 12 ¶ 4. However, as Ms. Smigels' and Mr. Yatooma's testimony above made clear, for the purposes of the Fee Application the Hazlewood matter and the Media Arts general file were coterminous.

Additionally, Mr. Yatooma's deposition testimony from May 2006 indicates that the Fee Application bills were the bills that would be sent to Hazlewood. Mr. Yatooma testified that "the bills were not recreated" after the fact, and that "the bills that you have are what's on the system." First Levitt Dec., Exh. 89, Yatooma Dep. at 16:20-17:7.

C. The Ejbeh Affidavit

During his deposition, Mr. Ejbeh, who at one time was an attorney at the Yatooma Firm, testified at length regarding his concerns with the Fee Application and the time attributed to him. According to Mr. Ejbeh, at one point observed a note at the Yatooma Firm detailing the billing protocol for Media Arts matters, stating that 100 percent of Media Arts time should be allocated to Hazlewood, 50 percent to White and 50 percent to the remaining clients. Second Levitt Dec., Exh. 2 at 89:14-23. Mr. Ejbeh confronted Mr. Yatooma about this note, and Mr. Yatooma confirmed that the allocation was correct. *Id.* The two men then engaged in a heated exchange in which Mr. Ejbeh claimed that the allocation procedure was "not right," and that Mr. Yatooma could not "do that." *Id.* at 89:25-90:1. Mr. Yatooma then explained that he was not planning on collecting the fees multiple time, but that he was "front-loading them on Hazlewood" to prevent "Media Arts and all the racketeers and the crooks that they are" from benefitting from the fact that attorney work product was being shared by multiple clients. *Id.* at 90:2-10.

Mr. Yatooma stated that this procedure was necessary to "recover up front all of his fees." *Id.* at 90:9-10. Mr. Ejbeh accepted the truth of Mr. Yatooma's explanation but did not agree that it was an acceptable approach to billing, and stated as much to Mr. Yatooma, leading to further heated arguing between the two men. *Id.* at 90:21-91:19.

Subsequent to this confrontation, Mr. Ejbeh received an affidavit for his signature attesting to the accuracy of the time attributed to him in the Fee Application. Mr. Ejbeh refused to sign the affidavit. On June 20, 2006, Mr. Ejbeh sent an email to an attorney at the Yatooma Firm stating:

> I have reviewed the billable time that NYA submitted to the Panel that is the subject of the Affidavit and compared the time to my billing sheets and records. The difference is night and day. I cannot reconcile the numbers even under the stated billing policy that Mr. Yatooma described to me last night. Hence, I cannot sign anything supporting the billable statements that were submitted to the Hazlewood Panel that do not comport with my billable time sheets and records.

Second Levitt Dec., Exh. 17. According to his deposition testimony, Mr. Ejbeh felt that the time entries attributed to him "appeared to be inaccurate from the standpoint that time entries that were Media Arts general had been upgraded to higher amounts," and that the process that he and Mr. Yatooma "had fought about was indeed implemented and carried out and

that's what he [Mr. Yatooma] was arguing for on his fees." *Id.* at 95:10-16. Mr. Ejbeh therefore refused to sign the affidavit despite Mr. Yatooma's assurance that he was "'going to tell the panel that [he was] not going to bill twice.'" *Id.* at 95:22-23. The conversation regarding the affidavit ended with Mr. Ejbeh stating that he did not have knowledge of what Mr. Yatooma was doing with respect to the bills, and that he therefore could not sign the affidavit. *Id.* at 95:24-96:5.

During his deposition, Mr. Ejbeh reviewed the portions of the Fee Application hearing transcripts referenced above, and was asked whether they alleviated his concerns with respect to the bills. In response, Mr. Ejbeh testified that if Mr. Yatooma disclosed to the Panel that he was "taking 100 percent of the Media Arts general time and . . . sticking it into the Hazlewood bill" to recover 100 percent of the time from Hazlewood, and further told the Panel that "he will not collect twice and not recover duplicatively . . . and that each client will pay the proportionate share and get a credit if any money comes back," and the Panel "contemplates it and they stick that in their final award, then I don't have a problem with it." *Id.* at 285:2-17. He further testified that he did not have that information when he was given the affidavit in June and therefore could not sign it, because at the time he had no way of knowing what representations Mr. Yatooma would make to the Panel. *Id.* at 285:17-24.

D. Evidence of Concealment

As further evidence in support of their allegation that defense counsel concealed the fact that they were seeking all Media Arts fees rather than only those fees allocated to the Hazlewoods, plaintiffs claim that Mr. Yatooma ordered his staff to destroy evidence that other Media Arts clients were obligated to pay large portions of the claimed fees. For example, plaintiffs have identified an email from Mr. Yatooma to his staff in which he responded to the question, "When I am copying receipts – should I try to take off other case names (White, Wittman, etc.)?" with "Yes, remove other case names." Second Levitt Dec., Exh. 3 at 992-996. Additionally, the descriptions of the time entries were altered in some circumstances to remove references to other Media Arts cases. Mr. Ejbeh's timesheets from March 30, 2005 and March 31, 2005, for example, contain the entry "Attendance at trial testimony of Terry Sheppard to be used in all MDA cases." Third Levitt Dec., Exh. 6. In the Fee Application bills, however, the entry is simply "Attended trial testimony of Terry Sheppard." First Levitt Dec., Exh. 55 at 4494.

III. Contemporaneous Timesheets

Plaintiffs claim that newly discovered evidence establishes that defense counsel did, in fact, use and maintain contemporaneous timesheets and pre-bills, and that they concealed this fact from the Panel. In particular, plaintiffs deposed former employees of the

Yatooma Firm who testified as such, and the Yatooma Firm has since produced hundreds of contemporaneous timesheets. Second Levitt Dec., Exhs. 1-4, 20. Defendants assert that these timesheets, totaling over 2,000 pages, represents not all or even a majority of the firm's contemporaneous timesheets, but only those that could be located in light of the firm's practice of deleting time entries. Additionally, defendants claim that these documents are simply printouts from the Yatooma Firm's billing software, rather than traditional timesheets. Accordingly, defendants argue, their initial assertion that contemporaneous timesheets were not maintained is not contradicted by the fact that they were able to produce these records. Defendants further claim that computer printouts were submitted to the arbitration panel.

Evidence related to the specific practices of the Yatooma Firm in terms of creating, maintaining and deleting contemporaneous timesheets is muddled by conflicting deposition testimony colored by glaring credibility concerns on the part of certain witnesses. In her original deposition, Ms. Smigels testified that time was recorded via email or dictation, and the tapes and emails were erased and deleted once the time was input into the billing software. First Levitt Dec., Exh. 92, Smigels Dep. at 23-25. Ms. Smigels further testified that, other than the information available on the computer software, there was no written record of an attorneys' time apart from "random emails" that were deleted. *Id.* at 25. Ms. Smigels acknowledged, however, that "the program is ordered

in such a way that if you want to print out the time of a specific lawyer on a matter, you can do that," by "simply giving some sort of command to the software." *Id.* at 24:19-24. Ms. Smigels did not mention Excel spreadsheets.

Mr. Yatooma's testimony was largely consistent with Ms. Smigels'. Mr. Yatooma testified that attorneys at the firm recorded time either by dictation or sending email, and that no written records were kept other than emails and copies of the final bills. First Levitt Dec., Exh. 89 at 7. Mr. Yatooma further testified to his understanding that Ms. Smigels deleted the emails after entering them into the system. *Id.* Finally, Mr. Yatooma confirmed his understanding that tapes were erased after being transcribed. *Id.* at 8-9. Mr. Yatooma likewise did not mention Excel spreadsheets.

The claims of Ms. Smigels and Mr. Yatooma regarding the absence of contemporaneous time records are in conflict with testimony from former employees of the Yatooma Firm, each of whom testified to the existence of Excel spreadsheets which allegedly contained contemporaneous time recordings. Mr. Ejbeh testified that he was able to retrieve all of his 2005 timesheets from the Yatooma Firm's computer systems in Fall 2005. Second Levitt Dec., Exh. 2, Ejbeh Dep. at 81-82. In addition to these timesheets, Mr. Ejbeh testified that Mr. Yatooma gave him a large stack of Mr. Yatooma's own timesheets in November 2005, including many of the timesheets that were ultimately produced in response to this court's subpoena, so that

Mr. Ejbeh could go over the records and come up with a billing protocol with which he was comfortable. *Id.* at 105-108.

Suzanne Connolly, a former office manager at the Yatooma Firm, additionally testified that all attorneys and paralegals at the Yatooma Firm created timesheets using Excel. Second Levitt Dec., Exh. 1, Connolly Dep. at 72:14-23. She further testified that hard copies of each employee's timesheets were stored in a filing cabinet, stored by attorney name. *Id.* at 73-74. Connolly stated that this was the practice until she left the firm in April 2006. *Id.* at 74:19-25. Additionally, she testified that she was never instructed to destroy these hard copies. *Id.* at 75:1-2. Finally, Connolly testified that the firm maintained electronic records of the Excel spreadsheets in addition to hard copies. *Id.* at 75:3-9.

Nicole Polasek, another former employee, testified that, once contemporaneous Excel timesheets were created, they were available in electronic form on the firms' computer system "[u]nless somebody else deleted [them]." Second Levitt Dec., Exh. 4, Polasek Dep. at 35-36. She further testified that she had never been instructed to delete contemporaneous timesheets or witnessed anyone else deleting them. *Id.* at 36-37. Polasek additionally testified that, while hard copies of Excel timesheets were printed out if an employee wanted to review them, she did not recall the Excel sheets being printed out for recordkeeping purposes. *Id.* at 97.

Finally, Matthew Morin, the Yatooma Firm's computer consultant, testified that he could have determined easily whether Mr. Ejbeh's contemporaneous timesheets were available in electronic form, and that deleting emails from Smigel's inbox would not have permanently deleted the records. Second Levitt Dec., Exh. 5, Morin Dep. at 53:6-54:2, 100:8-17. Despite this, Morin was never asked to search the computer system for deleted timesheets. *Id.* at 89:11-90:11.

Without denying the substance of these witnesses' testimony, defendants attack the credibility of two of these witnesses. Connolly, defendants point out, recently pled guilty to felony charges of larceny and embezzlement from the Yatooma Firm and a charitable foundation founded by Mr. Yatooma. Defs.' Exh. 8. Needless to say, there is a great deal of ill will between Connolly and the Yatooma Firm, and Mr. Yatooma himself, that requires this court to question her credibility. Notably, Connolly is the only witness who testified to a systematic method of maintaining both hard copies and electronic versions of the contemporaneous Excel spreadsheets, and the only one to testify that this practice was followed by all attorneys and paralegals at the Yatooma Firm. In light of the substantial credibility concerns associated with Connolly, the court is hesitant to give dispositive weight to her testimony.

Additionally, Mr. Ejbeh had been recently sued by the Yatooma Firm for allegedly taking the firm's clients, and had been enjoined from further client

contact and required to repay money to the Yatooma Firm. Even if Mr. Ejbeh's testimony were discounted, however, defendants do not deny the authenticity of the hard documentary evidence that he produced – namely, the contemporaneous timesheets that Ms. Smigels and Mr. Yatooma previously claimed were not available.

IV. Perjury

Plaintiffs allege that Ms. Smigels and Mr. Yatooma committed perjury on two grounds, both of which are related to other fraud allegations. First, plaintiffs claim that Ms. Smigels' and Mr. Yatooma's testimony as to the Yatooma Firm's practices related to the destruction of contemporaneous time records was perjurious in that Ms. Smigels and Mr. Yatooma falsely denied the existence of these records. Second, plaintiffs claim that the affidavits authenticating the Fee Application bills, and testimony regarding the authenticity of these bills, were fraudulent in that they falsely represented that the Fee Application bills genuinely set forth the fees assessed against defendants. The strength of plaintiffs' perjury allegations, therefore, depends on the veracity of plaintiffs' additional claims of fraud.

V. Duplicative Billing

Finally, plaintiffs claim that defendants improperly sought to recover attorneys' fees that had already been paid by other clients, and concealed that fact from plaintiffs and the Panel. After this court granted

plaintiffs' discovery motion, defendants produced bills sent to other clients for work performed in October through December 2004 which had been listed on the Fee Application bills. Second Levitt Dec., Exhs. 21 & 23. The production also included checks from these other clients in payment of the bills. Second Levitt Dec., Exhs. 22 & 24. Defendants do not deny that they sought fees and expenses that had been billed to other Media Arts clients, but claim that they fully disclosed that fact to the Panel along with their intent to credit those clients if they recovered those fees in the arbitration proceeding. However, defendants cite no specific representations to the Panel stating that they had received these payments.

LEGAL STANDARD

The Federal Arbitration Act ("FAA"), 9 U.S.C. sections 1 *et seq.*, allows a district court to vacate the decision of an arbitration panel in certain situations, including "where the award was procured by corruption, fraud, or undue means." 9 U.S.C. § 10(a)(1). "Courts have interpreted this section narrowly, in light of Supreme Court authority strictly limiting federal court review of arbitration decisions." *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056, 1060 (9th Cir. 1991). To vacate an award based on fraud or undue means, the party seeking vacatur must show that the behavior constituting fraud or undue means was "(1) not discoverable upon the exercise of due diligence prior to the arbitration, (2) materially related to an issue in the arbitration,

and (3) established by clear and convincing evidence." *A.G. Edwards & Sons, Inc. v. McCollough*, 967 F.2d 1401, 1404 (9th Cir. 1992) (per curiam).

DISCUSSION

I. Procedural Challenges

In addition to responding to the substance of plaintiffs' motion to vacate related to attorneys' fees and costs, defendants assert that the motion itself is improper. Specifically, defendants claim that plaintiffs' latest motion to vacate is inconsistent with the court's previous orders, and untimely under the requirements of the FAA.

Apparently some confusion has arisen from the fact that plaintiffs initiated the instant action by filing a motion to vacate the arbitration award, including the award of attorneys' fees, on November 10, 2006, and subsequently requested discovery as to the issue of attorneys' fees. In granting defendants' motion, the court contemplated additional briefing related to the attorneys' fee issue, but decided to move forward with the original motion as it related to the balance of the arbitration award.

Plaintiffs filed this motion to vacate the award attorneys' fees on March 12, 2007, the date set by this court for the filing of plaintiffs' opening brief. In essence, defendants claim that this new motion is improper, and plaintiffs were directed to brief only the issues raised in the November 10, 2006 motion.

Defendants apparently raise this objection in order to prevent plaintiffs from arguing two issues raised for the first time in the new motion: (1) plaintiffs' request to vacate the award of costs, in addition to the award of attorneys' fees, and (2) plaintiffs' request for an award of their own attorneys' fees in bringing this motion. In addition to its argument based on the court's orders, defendants assert that plaintiffs were required to assert all grounds for vacatur within the three-month time limit imposed by the Federal Arbitration Act. 9 U.S.C. § 12.

With respect to their first argument, plaintiffs have pointed to numerous instances in their original pleading identifying costs as a part of the award being challenged. The $900,000 award was an award of "[a]ttorneys' fees and costs." Final Award at 16. Likewise, plaintiffs specifically mentioned costs several times in their original Notice of Motion and Memorandum of Points and Authorities, and supporting declarations. Notice at 1, MP&A at 13. Accordingly, defendants were on notice from the outset that plaintiffs were challenging the award of costs as well as fees, and defendants' procedural objections fail as to the costs award.

As to plaintiffs' request for their own attorneys' fees, this is a separate request, not part of the original motion to vacate, that arises out of plaintiffs' purported newly discovered evidence of fraud. This request is properly before the court.

II. Fraud

Defendants assert that the proper measure of "fraud" sufficient to vacate an arbitration award in this context is "fraud on the court." The court finds no support for the proposition that the FAA imposes the exacting standard of "fraud on the court" in order to support vacatur, and this assertion is inconsistent with Ninth Circuit authority addressing fraud in the context of the FAA. *Compare Dogherra v. Safeway Stores, Inc.*, 679 F.2d 1293, 1297 (9th Cir. 1982) (holding that "obtaining an award by perjured testimony constitutes fraud" for the purposes of the FAA, as well as "intentionally giving a false statement to union investigators causing them to drop the grievance until after it was time-barred"), *with Appling v. State Farm Mut. Auto. Ins. Co.*, 340 F.3d 769, 780 (9th Cir. 2003) ("Non-disclosure, or perjury by a party or witness, does not, by itself, amount to fraud on the court."). Fraudulent conduct in the FAA context is conduct which violates Congress' expectation "'that the contractual machinery would operate within some minimal levels of integrity.'" *Dogherra*, 679 F.2d at 1297 (quoting *Hines v. Anchor Motor Freight*, 424 U.S. 554, 571 (1976)). Obtaining an award of attorneys' fees by submitting false evidence, or by concealing salient evidence, constitutes fraud.

A. Whether the Fraud was Discoverable

In granting defendants' discovery motion, this court held that specific instances of fraud which were

not presented to the Panel, or discoverable by due diligence, could form the basis for vacatur of the award of attorneys' fees. The issue, therefore, is whether the specific fraud allegations raised by plaintiffs in this motion were presented to the Panel or discoverable during the proceeding.

Taken together, plaintiffs allege three fraudulent courses of conduct: (1) wrongfully denying the existence of contemporaneous timesheets and withholding them during the arbitration, (2) submitting false bills in support of their Fee Application, and (3) attempting to recover attorneys' fees that had already been paid by other clients. Defendants claim that each of these issues was fully briefed before the Panel. If this is the case, plaintiffs would be foreclosed from asserting them as grounds for vacatur. *A.G. Edwards & Sons*, 967 F.2d at 1404 (holding that "where the fraud or undue means is not only discoverable, but discovered and brought to the attention of the arbitrators, a disappointed party will not be given a second bite at the apple").

1. Timesheets

In opposing defendants' Fee Application, plaintiffs alleged that defendants had lied about the existence of time sheets. Defs.' Exh. 3 at 15-16. However, plaintiffs' original theory of deception was that defense counsel initially deceived the Panel into thinking that timesheets *did* exist, and later admitted that no such records were available. *Id.* Plaintiffs

alleged that defendants lied about the existence of timesheets in order to fraudulently manipulate the Panel and plaintiffs and stonewall the discovery process related to attorneys' fees. Plaintiffs' briefing makes clear, however, that plaintiffs were proceeding from the premise that the timesheets did not exist. *Id.* at 16 ("There are no daily time sheets and there never were daily time sheets at the Yatooma Firm.").

Because the facts underlying plaintiffs' new theory were discovered only after the award was issued, when plaintiffs communicated with former employees of the Yatooma Firm and obtained the timesheets themselves through discovery before this court, plaintiffs' allegation that defendants committed fraud in concealing the contemporaneous timesheets is properly presented to this court.

2. Fee Application Bills

Plaintiffs previously alleged that the Fee Application bills were "bogus" on the basis that by submitting them, the Yatooma Firm was "pretend[ing] that it actually charged for those hours, and misrepresent[ing] that its clients actually paid." *Id.* at 12. The basis for this argument was plaintiffs' allegation that "the Yatooma Firm never billed its clients on an hourly basis, did not send out bills on a monthly basis and it did not get paid current, or at all." *Id.* Significantly, plaintiffs also specifically alleged that the Fee Application bills overstated the amount of attorneys' fees that defendants were responsible to

pay. *Id.* at 14-15. Plaintiffs cited to hearing testimony in which Mr. Ejbeh stated that defendants had accrued attorneys' fees in the amount of $818,000 through April 21, 2005, and deposition testimony by Hazlewood stating that Mr. Ejbeh had told her that this figure was the value of attorneys' fees to that date. *Id.* Plaintiffs then cited the Fee Application bills themselves, which purported to show attorneys' fees through April 21, 2005 of $1,449,106. *Id.* at 15. In light of this, plaintiffs asserted that "[t]he Yatooma Firm is not only attempting to outright steal from the Respondents by submitting bogus bills, it is committing a direct fraud on this Court via its misrepresentations." *Id.*

These passages in plaintiffs' original opposition brief are strikingly similar to their arguments in the instant motion. Plaintiffs made the precise argument regarding the Fee Application bills to the Panel that it makes here, i.e. that they were fabricated in order to fraudulently inflate the amount of attorneys' fees to which defendants were entitled. Plaintiffs cited compelling evidence in support of this allegation to the Panel. Plaintiff raises no new arguments in this regard, but only cites additional evidence. "Newly discovered evidence does not justify vacation of an award." *LaFarge Conseils et Etudes, S.A. v. Kaiser Cement & Gypsum Corp.*, 791 F.2d 1334, 1339 (9th Cir. 1986). Furthermore, the Majority explicitly accepted plaintiffs' argument regarding the discrepancy between testimonial evidence and the Fee Application bills themselves as to how much money in fees had

been incurred through April 21, 2005. Final Award at 13-14. Because the Panel considered whether the Fee Application bills were authentic, plaintiffs may not raise this argument in support of their motion to vacate.[2]

3. Duplicative Billing

Finally, plaintiffs' original opposition addressed the related issues of consolidated billing and whether defendants were responsible for the fees claimed. Plaintiffs argued that defendants had failed to state in their Fee Application that they paid the fees now sought. Defs.' Exh. 3 at 24. Rather, plaintiffs claimed, "[a]t best there [was] conflicting testimony . . . that they *may* have paid $55,000 or $95,000, but none of that is documented anywhere," and defendants were therefore not entitled to attorneys' fees. *Id.* (emphasis

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[2] Similarly, plaintiffs are precluded from raising their additional fraud allegation regarding the Yatooma Firm's purported hourly rate. Plaintiffs claim that defendants' Fee Application fraudulently claimed that defendants were charged a flat rate of $425 per hour, across the board for every attorney in the firm, when the rate for at least one attorney – Mr. Ejbeh – was $375. Plaintiffs cite testimony from Mr. Ejbeh's deposition in support of this discrepancy. However, plaintiffs made this precise argument to the Panel in opposition the original Fee Application, citing a letter from Mr. Ejbeh demanding $375 per hour in compensation for a failed attempt at taking a deposition. Defs.' Exh. 3 at 12-14. Plaintiffs' renewed argument only adds additional evidence in the form of Mr. Ejbeh's testimony confirming this hourly rate. Because this argument was made to the Panel, it cannot support vacatur of the award of attorneys' fees.

in original). Plaintiffs additionally argued that defendants were not entitled to full recovery for consolidated depositions, but that the fees for these depositions should be reduced to defendants' pro rata share among each of the Media Arts clients. *Id.* at 45. However, nowhere did plaintiffs allege that the claimed fees had previously been paid by other clients, nor is there any indication that this fact was discoverable through the exercise of due diligence. Accordingly, to the extent that defendants fraudulently claimed fees that had already been paid, plaintiffs may raise this argument in support of the instant motion to vacate.

B. Material Relationship to an Issue in the Arbitration

To establish a material relationship to an issue in the arbitration sufficient to support vacatur of an arbitration award, plaintiffs must show that the fraud or undue means "caused the award to be given." *A.G. Edwards & Sons,* 967 F.2d at 1403.[3] This inquiry

[3] Plaintiffs appear to rely on *Bonar v. Dean Witter Reynolds, Inc.,* 835 F.2d 1378, 1383 (11th Cir. 1988), for the proposition that the material relation element "does not require the movant to establish that the result of the proceedings would have been different had the fraud not occurred." This holding appears to be at odds with the Ninth Circuit's causation requirement in *A.G. Edwards & Sons,* 967 F.2d at 1403. Because *Bonar* was decided in another circuit four years before *A.G. Edwards & Sons,* the court holds that plaintiffs are required to show that the result of

(Continued on following page)

is somewhat complicated in this case due to the fact that the Panel, rather than awarding the amount requested by defendants, arrived at its own number seemingly independent of the evidence and assertions set forth by defendants. In particular, the Panel's award of $900,000 is "based upon reasonable time and effort which amount is then reduced further by certain amounts for sanctions imposed during the course of the matter against Claimants' counsel." Final Award at 14.

In reaching this conclusion, the majority stated that the Fee Application bills were not a reliable indication of the actual fees incurred, and strongly suggested a finding that the bills themselves were fabricated. This holding was supported by two important observations. First, the Majority accepted plaintiffs' argument regarding the discrepancy between testimonial evidence and the Fee Application bills themselves as to how much money in fees had been incurred through April 21, 2005. *Id.* at 13-14. Additionally, the majority stated that "many of the fee entries are obviously unsupportable." *Id.* at 14. As an example of this, the majority observed that "Mr. Ejbeh claimed to have worked (and billed) exactly 20 hours for 20 straight calendar days including week-ends . . . – a feat that the entire Panel believes is not possible if proper time records were being

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the arbitration would have been different had the fraud not occurred.

maintained." *Id.* The Majority further noted its "reservations about the validity of" the billing agreement between defendants and their counsel.

Despite the evidence that defendants had submitted false evidentiary support for their Fee Application, the majority further concluded that "to deny Claimants' Counsel any fees whatsoever would be arbitrary and demonstrate a sense of strong bias in favor of Respondents." *Id.* The dissent rejected this approach, claiming that "[t]he proper remedy when knowingly false support is offered for a claimed reimbursement is to deny the reimbursement entirely rather than to try, as the Majority did, to figure out what was reasonable in the circumstances. . . ." Dissent at 11. The dissent therefore would have denied attorneys' fees outright. *Id.*

This court addressed this ambiguity in its order regarding plaintiffs' discovery motion, concluding that plaintiffs should be permitted to pursue their fraud allegations regarding the attorneys' fee award, for two reasons. First, although the Majority's award of $900,000 is purportedly based on the Majority's determination of reasonable fees, elsewhere in the Final Award the Majority suggests that the award is consistent with the Dissent's agreement to reduce the request by approximately two thirds. Final Award at 14. Because defendants' ultimate fee request totaled was $2,669,016.25, the $900,000 is approximately one third of the requested amount. *Id.* at 13; *Thomas Kinkade Co.*, 2007 WL 217384 at *1 n.1. Additionally, the court concluded that, "given the seriousness of the

allegations raised by plaintiffs in their discovery request, the court finds that it is likely the panel would have acted differently if such allegations had been raised and proven during the proceedings below." *Id.* at *4. Specifically, the court stated its belief that "[a]t the very least, the panel might have increased its monetary sanctions and reduced its ultimate attorneys' fee award." *Id.*

This court, "as guardian of the integrity of the arbitration process and the integrity of the court's confirmation or vacation of the arbitration award," must therefore "satisfy itself" that the attorneys' fee award was reduced by amount consistent with the full scope of dishonest conduct on the part of defendants and defense counsel. *Id.* Accordingly, to the extent that plaintiffs have shown clear and convincing evidence of fraud, this court will reduce or vacate the award of attorneys' fees commensurate with the newly revealed fraudulent conduct.

C. Clear and Convincing Evidence

There is no doubt that defense counsel took a creative approach to their Fee Application, both in their extraordinary claim that they were entitled to fees that defendants were not responsible to pay, and in the fact that they literally (and admittedly) created false legal bills they had no intention of submitting to their clients. The Panel, however, understood that both of these things were happening, and adjusted the fee award accordingly. Furthermore, the fact that

defense counsel was requesting fees that had already been partially paid by other clients does not constitute clear and convincing evidence of fraud. Defense counsel advised the Panel that they were seeking fees that would ultimately be levied against other clients in the event that the Panel did not grant a full award. The Panel understood that any award defense counsel received would be credited to defendants and other clients. Ideally, defense counsel would have disclosed that certain fees had already been paid, and that therefore a full award would lead them to issue refunds to certain clients. However, the fact that defense counsel was not entirely candid about this situation did not unduly compromise the Fee Application. Furthermore, the court finds no reason to require defense counsel to have held off on collecting fees from other clients pending the resolution of their Fee Application. Accordingly, defense counsel's failure to disclose the fact that they had received payments from other clients does not constitute clear and convincing evidence of fraud.

The most glaring inconsistencies lie in the varying representations regarding the availability of contemporaneous timesheets at the Yatooma Firm. Here too, however, plaintiffs have failed to produce clear and convincing evidence of fraud. The only witness who testified to a systematic policy of maintaining electronic and hard copies of all timesheets was Connolly, whose credibility is decimated both by guilty pleas to larceny and embezzlement and by personal animosity toward the Yatooma Firm. The

court's doubts related to Connolly's credibility are cast into sharper relief by the fact that her detailed recollections regarding the Yatooma Firm's record-keeping practices were not corroborated by the other witnesses, including those witnesses hostile to defense counsel. The remaining testimony to which plaintiffs cite establishes, at best, that there was no set policy regarding the retention of timesheets. Rather, each timekeeper maintained his or her own records according to personal preference. While the Yatooma Firm could have recovered its deleted timesheets through simple technological means, plaintiffs could have deduced this from the original testimony and do not appear to have pressed the issue at the time. Furthermore, the availability of computer print-outs from the firm's billing software has been known to plaintiffs since Ms. Smigels' original deposition.

In sum, plaintiffs have not established that the Yatooma Firm's failure to recover its deleted timesheets was the result of intentional deception rather than simple incompetence or laziness. The Yatooma Firm took a gamble by submitting an excessive fee request without bothering to gather reliable evidentiary support. In return, the Majority slashed their fee request by two thirds. Based on the overall equities of the case, the Majority decided that plaintiffs were entitled to an award of attorneys' fees despite the undisguised excesses and fabrications on the part of plaintiffs' counsel. Absent clear and convincing evidence of additional, undiscovered fraud, this court cannot disturb that result.

III. Undue Means

The term "undue means" as used in the FAA "clearly connotes behavior that is immoral if not illegal." *A.G. Edwards & Sons*, 967 F.2d at 1403. "[M]ere sloppy or overzealous lawyering" does not constitute "undue means." *Id.* Although plaintiffs separately argue that the attorneys' fee award should be vacated because it was procured by undue means, their entire argument in this regard is that the Yatooma Firm acted in bad faith in pursuing its Fee Application. Because plaintiffs have not submitted clear and convincing evidence of immoral or illegal behavior by the Yatooma Firm, they are not entitled to vacatur of the fee award based on undue means.

IV. Effect of Vacatur of the Arbitration Award

By order dated June 5, 2007 this court granted plaintiff's motion to vacate the arbitration award, based on the Panel's failure to provide plaintiffs with an adequate hearing. Docket Entry 167. The court ordered the parties to submit supplemental briefs regarding the effect of this vacatur on the instant motion to vacate the award of attorneys' fees.

The Panel's decision to award attorneys' fees and costs to defendants was explicitly premised on its determination that defendants were the prevailing party in the arbitration. Final Award at 12. Because this court has vacated that determination, the factual predicate for the award of attorneys' fees has evaporated, and the award of attorneys' fees and costs must

likewise be vacated. Appellate courts have reached similar conclusions in reversing district court judgments. *See, e.g., Pedigo v. P.A.M. Transport, Inc.*, 98 F.3d 396, 398 (8th Cir. 1996) (holding that "an order awarding attorney's fees based on a party having prevailed in a trial court cannot survive the reversal of that party's judgment on appeal"). To hold otherwise would be contrary to the provisions of the FAA. Having determined that plaintiffs were denied a proper hearing, all of the Panel's resulting decisions must be nullified to avoid giving effect to the defective process.

Defendants nonetheless assert that they remain entitled to their award of attorneys' fees. First, defendants claim that the fee award was not based on a determination that defendants were the prevailing party. Defendants cite the Majority's statement that "[t]he basis for an award of attorneys' fees in this case is AAA Rule R-43(d)(ii) in that the FAC and the Response and Counterclaim each seek an award of reasonable fees in this proceeding." Final Award at 13. Rule R-43(d)(ii) provides that an arbitration award may include "an award of attorneys' fees if all parties have requested such an award or it is authorized by law or their arbitration agreement." As the dissent noted, however, "[w]hile there is no reference in Rule R-43(d)(ii) to 'prevailing party,' the Majority properly adopts that standard in applying that Rule in order to determine entitlement." Dissent at 10. This is consistent with the Majority's introductory statement regarding its decision to allow defendants

to seek attorneys' fees and costs. The Panel clearly would not have invited defendants to file a motion seeking fees and costs had the Panel not first improperly determined that defendants were the prevailing party.[4]

Additionally, defendants claim that the award of attorneys' fees included monetary sanctions against defense counsel, which this court should not disturb. The Majority stated that it arrived at its figure for the fee award based on a host of factors, without providing any detailed analysis. Final Award at 14. It is therefore impossible for this court to determine to what extent, if any, the award reflects monetary sanctions against defense counsel. However, the Majority additionally stated that "Counsel for both sides acted at certain times beneath standards of conduct which this Panel had the right to expect." *Id.* Accordingly, sanctions against defense counsel may have been offset by, or even exceed [sic], sanctions against plaintiffs' counsel, particularly in light of the drastic reduction that the Majority applied to defendants' initial fee request. Accordingly, this ambiguity in the award does not alter the court's conclusion that the award of

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[4] Defendants separately argue that the Panel had independent authority to award attorneys' fees because both parties consented to such authority by request [sic] attorneys' fees. *See Coutee v. Barington Capital Group, L.P.*, 336 F.3d 1128, 1135-36 (9th Cir. 2003). While the parties in this action clearly consented to granting the Panel authority to award attorneys' fees, the ultimate award must still be supported by a fair hearing.

attorneys' fees and costs must be vacated along with the arbitration award itself.

V. Plaintiffs' Request for Attorneys' Fees

Generally, the prevailing party in an FAA action may not collect attorneys' fees. However, "[a] court may assess attorneys' fees 'when the losing party has "acted in bad faith, vexatiously, wantonly, or for oppressive reasons."'" *Dogherra,* 679 F.2d at 1298 (quoting *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y,* 421 U.S. 240, 258-59 (1975)). Such an award "is puntive and the penalty can be imposed only in exceptional cases and for dominating reasons of justice." *Id.* (internal quotations omitted). "Within these guidelines, an award of attorneys' fees is within the district court's discretion." *Id.*[5]

As discussed above, plaintiffs' newly discovered evidence shows sloppiness and sharp practices on the part of the Yatooma Firm, but this court cannot say that the level of misconduct warrants the imposition of attorneys' fees. Accordingly, plaintiffs are not entitled to their own attorneys' fees.

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[5] Defendants argue that attorneys' fees in the FAA context are available only within two narrow exceptions. However, the discussion of attorneys' fees in *Dogherra* was not premised on either of these exceptions, and there is no reason not to interpret its guiding language as generally applicable.

CONCLUSION

While no independent basis under the FAA exists for specifically vacating the award of attorneys' fees and costs, the award cannot stand in light of the vacatur of the arbitration award. Accordingly, plaintiffs' motion to vacate the award of attorneys' fees and costs is GRANTED. Plaintiffs' request for attorneys' fees is DENIED.

IT IS SO ORDERED.

Dated: July 17, 2007

/s/ Marilyn Patel
MARILYN HALL PATEL
United States District
Court Judge
Northern District
of California

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

THE THOMAS KINKADE COMPANY, f/k/a MEDIA ARTS GROUP, INC., a California corporation and RICHARD F. BARNETT,

Plaintiffs,

v.

KAREN HAZLEWOOD, JEFF SPINELLO, and THOMAS KINKADE AT THE DOWNTOWN MALL, LLC, a Virginia corporation,

Defendants.
/

No. C 06 7034 MHP

MEMORANDUM & ORDER

Re: Defendants' Motion to Direct a Rehearing

(Filed Aug. 29, 2007)

Plaintiffs The Thomas Kinkade Company and Richard F. Barnett (collectively "plaintiffs") have appealed an arbitration award issued in favor of Karen Hazlewood, Jeff Spinello and Thomas Kinkade at the Downtown Mall, LLC (collectively "defendants") in October 2006. This court issued an order granting plaintiffs' motion to vacate the award on June 6, 2007. Defendants now move the court to direct a rehearing before the Arbitration Panel ("the Panel"). Having considered the arguments of the parties and for the reasons set forth below, the court enters the following memorandum and order.

BACKGROUND

The background of the dispute between plaintiffs and defendants is set forth in this court's previous Order on Plaintiffs' Motion to Vacate Arbitration Award, Docket Entry 167 ("Vacatur Order"). The action before this court arises from a Final Arbitration Award issued in favor of defendants in October 2006. Plaintiffs filed a motion to vacate the arbitration award on November 13, 2006, and defendants filed a motion to confirm the arbitration award on December 8, 2006. This court entered an order granting plaintiffs' motion on June 6, 2007.

In its Vacatur Order, this court found several grounds for vacatur. First, the court found that the Panel exceeded its authority by awarding damages in the form of lost profits. Vacatur Order at 16. The court held that the lost profits award was barred by a contractual damages limitation, and that "the damages limitation provision was a valid circumscription of the Panel's authority, which remained operative as part of the valid arbitration agreement." *Id.* Second, the court found that the Panel lacked authority to shift non-neutral arbitrator fees to plaintiffs. *Id.* Finally, the court held that, in determining that plaintiffs were liable for fraud, "the majority improperly relied on allegations and evidence related to a pleading that the Panel had explicitly rejected, without affording plaintiffs an opportunity to conduct discovery or present evidence in rebuttal." *Id.* at 21. Because of this denial of a proper hearing, the court held that the entire award must be vacated. *Id.* at 28.

Defendants filed a motion for reconsideration of the Vacatur Order on July 5, 2007, which the court denied the following day. Defendants now move the court to direct a rehearing before the Arbitration Panel.

LEGAL STANDARD

The Federal Arbitration Act ("FAA"), 9 U.S.C. sections 1 *et seq.*, governs district court review of decisions by an arbitration panel. "If an award is vacated and the time within which the agreement required the award to be made has not expired, the court may, in its discretion, direct a rehearing by the arbitrators." 9 U.S.C. § 10(b). However, "[a]rbitrators are not and never were intended to be amenable to the 'remand' of a case for 'retrial' in the same way as a trial judge." *McClatchy Newspapers v. Central Valley Typographical Union No. 46,* 686 F.2d 731, 733 (9th Cir. 1982) (quoting *Washington-Baltimore Newspaper Guild, Local 35 v. Washington Post Co.,* 442 F.2d 1234, 1238 (D.C. Cir. 1971)). Remand is appropriate, therefore, to allow an arbitrator to "correct a mistake which is apparent on the face of his award, complete an arbitration if the award is not complete, [or] clarify an ambiguity in the award." *Id.* at 734 n.1. Remand is inappropriate for the purposes of "reexamination of the merits, or a modification of the award." *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.,* 299 F.3d 769, 780 (9th Cir. 2002), *vacated on other grounds,* 347 F.3d 987 (9th Cir. 2003).

DISCUSSION

I. Procedural Challenges

Plaintiffs raise three procedural challenges to defendants' motion. These challenges merit little discussion. First, plaintiffs claim that the "time within which the agreement required the award to be made" has expired, and therefore remand is unavailable. Plaintiffs rely on the fact that the arbitration agreement specified that the arbitration would be governed by the AAA rules, and that AAA Rule R-41 places a thirty-day time limit on the making of an award. *See* Vacatur Order at 17. This court has previously declined to treat Rule R-41 as a rigid bar in this action. *Id.* at 19. Furthermore, the AAA rules themselves acknowledge the possibility of subsequent legal action, and it is therefore unreasonable to presume that the thirty-day time limit, which is incorporated into the arbitration agreement by reference only, acts as an agreement to forestall remand to the arbitrators. *See* AAA Rules 46 & 47.

Second, plaintiffs assert that the instant motion is a motion for reconsideration which has been improperly filed without leave. The court fails to see how this motion qualifies as a motion for reconsideration.

Finally, plaintiffs assert that defendants are barred from pursuing the instant motion by the doctrine of judicial estoppel, which in certain circumstances prevents parties from taking inconsistent positions during the course of a single litigation. *See*

New Hampshire v. Maine, 532 U.S. 742, 749 (2001). This argument, too, is unavailing. Plaintiffs' previous attempt to confirm the arbitration award is not clearly inconsistent with its current attempt to remand the matter to the Panel to correct the defects identified in this court's Vacatur Order. Additionally, judicial estoppel requires the court to have adopted the previous inconsistent position. Although defendants offer a very loose interpretation of this requirement, the fact remains that this court denied defendants' prior motion and vacated the arbitration award in its entirety.

Accordingly, this motion is procedurally proper. The court therefore considers whether remand is appropriate under the FAA.

II. Remand

The parties disagree as to the correct standard to be applied when considering a section 10(b) motion. Plaintiffs rely heavily on the doctrine of *functus officio,* which generally provides that once an arbitration panel has issued a decision regarding the issues submitted, the panel lacks any power to reexamine that decision. *See, e.g., Colonial Penn Ins. Co. v. Omaha Indem. Co.,* 943 F.2d 327, 331-332 (3d Cir. 1991). Defendants, in response, cite cases from other jurisdictions holding that the doctrine has limited applicability. For example, in *Glass, Molders, Pottery, Plastics & Allied Workers Int'l Union v. Excelsior Foundry Co.,* 56 F.3d 844, 846 (7th Cir.

1995), Judge Posner described the doctrine as "riddled with exceptions" and "hanging on by its fingernails," and questioned whether the doctrine still exists in the context of labor arbitration.

Turning to Ninth Circuit authority, it is clear that this Circuit does not share Judge Posner's hostility toward the finality of arbitrator jurisdiction, and allows for remand only in cases where some discrete error or ambiguity remains to be resolved by the Panel. For example, in *Sunshine Mining Co. v. United Steelworkers of Am.*, 823 F.2d 1289, 1295 (9th Cir. 1987), the court held that remand to the arbitrator was required because the lack of a psychiatric examination had rendered the award "incomplete," and thus the arbitrator had not rendered a "complete determination of the issue submitted." Conversely, in *McClatchy Newspapers*, 686 F.2d at 734 n.1, the court held that the exceptions to the rule against arbitrator reexamination did not apply because the party seeking remand sought to "introduce new evidence for the specific purpose of convincing the arbitrator that his decision was erroneous."

Accordingly, remand in the instant action is appropriate only if defendants can identify a specific error, incompleteness, or ambiguity in the Panel's final award. Defendants have identified three issues which they claim should be resubmitted to the Panel: (1) defendants' claim of fraud in the inducement; (2) damages for the contract and tort claims; and (3) the limitation on damages for lost profits.

This court previously held that the Panel reached its finding of fraud in the inducement based on improper reliance on allegations pled only in defendants' rejected Second Amended Claim, without affording plaintiffs an opportunity to present their own evidence regarding these allegations. Defendants claim that the matter of fraud in the inducement should be remanded to the Panel so that the Panel may either render an award based solely on the First Amended Claim, or allow plaintiffs to present additional evidence. Under *McClatchy Newspapers,* however, remand to an arbitration panel to consider additional evidence is improper. The Panel in this action fully, albeit improperly, adjudicated defendants' fraud claim, and therefore its errors in disposing of the claim cannot be cured on remand.

Turning to the contract and tort claims, the Panel found that plaintiffs had breached the covenant of good faith and fair dealing, and had intentionally interfered with defendants' advantageous business relationships. First Levitt Dec., Exh. 1 ("Final Award") at 7-8. The factual bases for these holdings were separate from the problematic factual allegations in the Second Amended Claim that formed the basis for the improper fraud holding. *Id.* In fact, this court's Vacatur Order made no mention of these additional claims, nor did the parties raise this distinction at any point during the instant litigation. This was likely due to the fact that the Panel did not award any damages based on these additional findings

because defendants "could not adequately demonstrate any other damages than they had already sustained for fraud in the inducement." *Id.* at 7 & 8. Defendants now claim that there were damages attributable to the tort and breach of contract claims, and remand is necessary to determine what those damages are. Plaintiffs argue that this court's prior order vacated the entire award, and therefore the tort and contract findings have been held to be invalid.

Although this court did vacate the entire Final Award, the rationale for this holding was the denial of a hearing based on the fraud claim. The propriety of the hearing with respect to the tort and contract claims was never argued before this court, and this court has made no findings in that regard. The Final Award suggests that a certain amount of non-delineated damages were attributable to plaintiffs' breach of contract and tortious conduct, but is wholly ambiguous as to the extent and allocation of these damages. Accordingly, remand is appropriate for these damages to be determined. In determining these damages, the Panel may not consider any factual allegations not raised in the Second Amended Claim.

Finally, defendants argue that the Panel should be allowed to reconsider the damages limitation. This court has previously held as a matter of law that the contractual limitation barring an award of damages for lost profits was valid and applicable to the underlying arbitration. The Panel is not entitled to revisit this issue.

A final issue to be decided is whether the rehearing should be conducted before the panel that conducted the original arbitration. Defendants assert that remand to the original panel is appropriate to avoid a costly re-litigation of the entire lengthy arbitration proceeding. Plaintiffs assert that remand to the original panel would be prejudicial, largely for the reasons identified in defendants' previous submissions concerning apparent bias on the part of the arbitrators. While defendants have not provided sufficient evidence to support a finding of arbitrator bias or corruption justifying vacatur on those grounds, the record in this matter discloses a pattern of shenanigans and open acrimony among all parties involved that leaves this court hesitant to entrust further proceedings to the original arbitration panel. The specific issues to be decided on remand are sufficiently narrow to avoid the necessity of a full protracted litigation before a new panel. Accordingly, the remanded arbitration proceedings will take place before a new panel, to be chosen in accordance with the arbitration agreement.

CONCLUSION

For the foregoing reasons, plaintiffs' motion to direct a rehearing is GRANTED. The rehearing will be limited solely to the issues of (1) damages, if any, attributable to the Panel's finding of breach of the covenant of good faith and fair dealing and (2) damages, if any, attributable to the Panel's finding of

interference with advantageous business relationship. A new and different arbitration panel shall be chosen for the hearing on these issues, and the evidence considered will be limited solely to evidence previously submitted to the original arbitration panel related to the factual allegations in the First Amended Claim.

IT IS SO ORDERED.

Dated: August 29, 2007 /s/ Marilyn Hall Patel
MARILYN HALL PATEL
United States District
Court Judge
Northern District
of California

AMERICAN ARBITRATION ASSOCIATION
Commercial Arbitration Panel
No. 74 114 01360 03 SUBR

KAREN HAZLEWOOD, JEFF SPINELLO,
Claimants and Respondents by Counterclaim,

and

MEDIA ARTS GROUP, INC.; a Delaware corporation, LIGHTPOST PUBLISHING, INC.; THOMAS KINKADE; CHRISTOPHER HUNT; STEVE CAMPBELL; KAREN FOSS; MIKE HOPPER; RICHARD F. BARNETT; RON B. FORD; KENNETH E. RAASCH; RICHARD E. STEARNS; ERIC H. HALVORSON; HERBERT D. MONTGOMERY; ANTHONY D. THOMOPOULOS; MOE GRZELAKOWSKI; C. JOSEPH LABONTE; DONALD POTTER; RAYMOND A. PETERSON; STEVEN PASZKIEWICZ; MARCIE LOWE; TODD BALES; ASHLEY TAYLOR,
Respondents and Counterclaimants.

FINAL AWARD

(Filed Dec. 15, 2006)

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Place of Arbitration: **San Francisco, California; Santa Monica, California**

Date of Final Award: **October 4, 2006**

THE UNDERSIGNED ARBITRATORS, having been designated in accordance with the Dealer Agreements dated March 26, 1999 (Ex. 445) and September 18/20, 2000 (Ex. 446), and having been duly sworn and having examined the submissions, proofs and allegations of the parties, hereby render this Final Award as follows:

I. Introduction and Procedural Statement

Claimants and Respondent Media Arts Group, Inc. ("MAGI") entered into several Dealer Agreements for the distribution of paintings and other products featuring the art work of Thomas Kinkade. The dealer agreements each contained an arbitration clause. Claimants opened two galleries in Charlottesville (1999) and Fredericksburg, VA. (2000). They closed the galleries in March and November, 2003. Claimants commenced this proceeding on September 26, 2003.

The Panel. Claimants appointed Mayer Morganroth as their non-neutral arbitrator. Respondents appointed Richard Chernick as their non-neutral arbitrator. A motion to disqualify Mr. Morganroth was denied by the AAA. The party-appointed arbitrators appointed James H. Grossman as Chair of the Panel. The parties agreed that the non-neutral arbitrators might have *ex parte* communications with their respective parties until the commencement of the hearing and were to have limited communications with the parties on procedural and administrative

issues during the course of the Hearing. No *ex parte* communications were permitted as to the deliberations of the Panel on submitted matters at any time during the course of this proceeding.

Pleadings. Claimants filed a Claim in Arbitration on September 26, 2003. Respondents filed their Answer to Claim and Counterclaim on November 18, 2003. Claimants' First Amended Claim ("FAC") was filed on January 2, 2004. Respondents filed a motion to dismiss the FAC. The Panel's ruling was issued on April 27, 2004. It denied the motion except that it ordered 16 individual Respondents dismissed (all but Messrs. Campbell, Barnett, Hunt and Raasch). A further Order on the motion to dismiss was issued on July 20, 2004. Later, Claimants separately dismissed Marcie Lowe (who had previously been dismissed by motion) and Steve Campbell.

Claimants sought to reinstate Thomas Kinkade as a Respondent at the commencement of the evidentiary hearings and to assert additional claims. Claimants proposed to file a Second Amended Claim asserting these additional claims and naming Kinkade as a Respondent and the Panel directed Claimants to file a motion in that regard for the Panel to consider. After argument and hearing, on April 18, 2005, the Panel denied the motion for leave to file the Second Amended Claim, without prejudice. Claimants later renewed their motion to add Mr. Kinkade as a Respondent and to permit the filing of the proposed Second Amended Claim (in the form of a motion to amend to conform to proof). Those requests were

denied. The operative pleading is therefore the FAC and the Respondents remaining are MAGI, Raasch, Barnett and Hunt. Because no evidence was offered as to Hunt, all claims against him are dismissed. Raasch and Barnett are addressed below.

Respondents filed a motion for Summary Adjudication and later filed a Revised Motion for Summary Adjudication. The motion was opposed by Claimants. After hearing, the Panel granted the motion to dismiss all claims based on the Virginia Retail Franchising Act (FAC, Count One) and denied Claimants' motion to add a claim under the California Franchise Investment Act. Order dated December 10, 2004. The motion to dismiss claims for punitive damages was denied, without prejudice, on the basis that Claimants' fraudulent inducement claim, if successful, might effect a rescission of the Dealer Agreements which contain a waiver of the right to claim punitive damages. Order dated December 10, 2004.

Discovery Disputes. The Panel (and in some cases the Chairman acting alone) ruled on numerous applications for assistance in connection with the parties' conduct of discovery pursuant to their voluntary discovery stipulation. To the extent any rulings on discovery disputes are relevant to the issues determined in this Interim Award, they are addressed in the discussion, below.

Motions for Sanctions. Respondents sought the imposition of sanctions on Claimants' counsel for

contacting parties known to be represented by Respondents' counsel. The motion was granted as to Mr. Yatooma, with the Panel reserving the determination of the imposition of a specific sanction until the conclusion of the matter. The Panel denied Respondents' related request that Mr. Campbell not be permitted to testify.

Claimants sought reimbursement of expenses and other costs in connection with the deposition of Anthony Thomopoulos on the ground that he failed to appear as agreed. The Panel granted the motion and ordered Respondents to pay Claimants' counsel's out-of-pocket expenses for the deposition; the issue of payment of any additional costs (attorneys' fees) was deferred until the conclusion of this matter.

Respondents sought sanctions against Mr. Ejbeh on account of his unauthorized removal of a confidential and allegedly privileged document from the premises of MAGI contrary to instructions of the Chairman (who conducted a site visit to the MAGI video library with counsel). The motion was resolved by Order dated June 20, 2005 (Separate Statement filed by Arbitrator Chernick). That Order was supplemented and revised in the Order of August 12, 2005.

Claimants sought discovery sanctions against Respondent MAGI based on its allegedly wrongful refusal to produce documents in response to a written request for documents. The motion was resolved by Order dated August 12, 2005 (Separate Statement

filed by arbitrator Chemick). A motion to reconsider that ruling was heard and determined, denying the motion except as to the obligation of MAGI to have produced videotapes. The parties exchanged letters regarding this last point but no further ruling was made by the Panel.

Sanctions ordered by the Panel during the proceedings will be addressed in the Final Award.

The Evidentiary Hearing. The evidentiary hearing took place on December 15-18, 20-21, 2004; March 28-April 1, 2005; April 18-22, 2005; June 20-24, 2005; July 11-14 and 18-21, 2005.

Witnesses. The following witnesses were called and testified: Jeff Spinello (12/16-18, 2004; 12/20-21/04, 3/28/05); Steven Campbell (3/28-29/05); Leland Underwood (3/29/05); Israel Rodriguez (3/29/05, 6/20/05); Terry Sheppard (3/30-31/05; 4/1/05; 4/18/05); Karen Hazlewood (4/18/05, 4/20-21/05); John Dandois (4/19-20/05); William Morris (4/21/05); Patty Watson (deposition); Marcie Lowe (deposition); David Kamerschen (4/22/05); Victoria Amarillas (4/21-22/05, 7/18/05); William Ogden (6/20/05); Robert Murray (6/21-22/05); Herbert Montgomery (6/21, 6/23/05); Thomas Kinkade (6/22, 7/12/05); Anthony Thomopoulos (6/22/05); Ronald Parker (6/24/05); Kenneth Raasch (7/11, 7/13/05); Rick Barnett (7/13-14, 7/18-21/05); Todd Bales (7/12/05); Richard Asbill (7/21/05)

Documentary Evidence. Each side offered documentary evidence. The hearing was reported by Karen J. Fortna, CSR No. 5067 (Michigan).

At the conclusion of the testimony, each side stated that it had no further evidence to offer; the matter was argued in the form of written briefs submitted by counsel (November 21 and 28, 2005) as well as reply briefs and was submitted for decision on December 5, 2005.

After the submission of the matter on December 5, 2005, Respondents filed two separate requests to reopen the evidence. Each was denied by a written Order (Orders dated January 27, 2006 and February 12, 2006). Claimants submitted further evidence as well; the Panel did not consider that evidence. Order dated January 27, 2006.

The Interim Award with concurring and dissenting opinions issued on February 23, 2006. The Majority in the Interim Award found for Claimants on the claim of fraud in the inducement based on what the Majority determined was clear and convincing evidence and awarded compensatory damages of Eight Hundred Sixty Thousand and One Hundred Dollars ($860,100). Having found fraud in the inducement, the Majority is of the view that any limitations on damages contained in a fraudulently obtained agreement would be of no force or effect. It found Claimants to be the prevailing parties and established a procedure for the submission of evidence and argument as to fees and costs. A hearing was conducted on July 31 and August 1, 2006. Testimony was offered and evidence submitted by both sides at the hearing. The fee and cost hearing was reported by Karen J. Fortna.

The resolution of those issues is addressed below. At that fee and cost hearing Respondents renewed their motion to disqualify counsel for Respondents; that motion was DENIED by a majority of the arbitrators (Grossman and Morganroth). The motion was renewed after the fee and cost hearing based on testimony given by Mr. Yatooma during the hearing. That renewed motion was DENIED by a majority of the arbitrators (Grossman and Morganroth). Claimant made a motion for imposition of a constructive trust. That motion was DENIED by the Panel.

II. Facts

The following is a statement of those facts found by the Arbitrator to be true and necessary to the Award. To the extent that this recitation differs from any party's position, that is the result of determinations as to credibility, determinations of relevance, burden of proof considerations, and the weighing of the evidence, both oral and written.

Claimants Karen Hazlewood and Jeff Spinello owned and operated an art gallery business in Charlottesville and Fredericksburg, Virginia through an entity known as Thomas Kinkade At the Downtown Mall, LLC, a Virginia limited liability company (the two individuals and the limited liability company collectively referred to herein as the "Claimants"). One of the Respondents, The Thomas Kinkade Company, is a California corporation ("TKC") and a successor in interest to another of the Respondents,

Media Arts Group, Inc. a Delaware corporation ("Media Arts"). Another Respondent, Richard F. Barnett, is a resident of the State of California and is or was an officer of Media Arts ("Barnett"). The Claimants allege that TKC is the successor in interest to Media Arts, a publicly traded company during the time periods allegedly relevant to the claims of the Claimants.

Media Arts had been engaged in the art distribution business and for most of its history distributed exclusively the work of the artist Thomas Kinkade. While at first the distribution was mainly through corporate owned stores, the Company expanded during the period from 1996 through 2001 through the use of tiered distributors with the so-called Signature Gallery program (SG Program") being at the highest end of the chain.

The Claimants became aware of the works of Mr. Kinkade and thereafter became interested in becoming licensed distributors and first applied in 1998 for a distributorship in North Carolina. The Claimants early on in the process in 1998 met Barnett who was then Senior Vice President for Retail Development and one of the key executives in the creation of the SG Program. Barnett had operated his own galleries in the Monterrey/Carmel California area before becoming part of the Media Arts executive team. Although Claimants learned that the location in North Carolina was not available, in November 1998, they still attended the Thomas Kinkade University (TKU), a training session held in Monterrey,

California where, allegedly, not only representations were made to them about the SG Program but also, allegedly, were many material facts relating to the prospective distribution arrangement were not disclosed to them. In December, 1998, after TKU, they sought an appropriate location in various alternative cities in Virginia with the assistance of Media Arts' representatives.

Also, subsequent to TKU, the Claimants engaged Pebble Beach Financial ("PBF") to assist in the development of their business plan for their gallery. The principals of PBF are Messrs. Underwood and Rodriguez, formerly respondents in this matter whom the Claimants released as respondents with prejudice. PBF had an active role in preparing business plans for many of the prospects seeking distributorships from Media Arts. This business plan development work for Claimants was being done in January 1999 at the same time that PBF was expressing its concerns with reference to the SG Program to Media Arts management. No mention of such concerns was made by PBF to the Claimants.

The Claimants were successful in filing their business plan with Media Arts and were approved by Media Arts. The Dealer Agreement setting forth the details of the contractual relationship between Media Arts and the Claimants was finally signed by Media Arts on March 26, 1999 ("Dealer Agreement"). Claimants opened their first gallery in Charlottesville on May 21, 1999. Prior to the opening, Claimants had requested, and an agent of Media Arts had agreed, to

close a discounting dealer in a nearby city in Virginia. No such closure occurred and in fact the promise was made again prior to the opening of Claimants' second location; however, again no such closure occurred. Claimants complained on both occasions to representatives of Media Arts. A second gallery was opened by Claimants on December 6, 2000 in Fredericksburg, Virginia.

Claimants, in their allegations that they were fraudulently induced into entering into the contract with Respondents, set forth in their filings extensive representations as well as failures to disclose material information made by various employees of Media Arts, while the Respondent consistently denied wrongdoing of any kind. These allegations include, but are not limited to, Respondent's assurance that 1) Claimants would be treated as if they were "partners"; 2) if Claimants "followed the recipe" they would succeed; 3) and there was more than just good faith involved in that Respondents followed strong religious and ethical principals [sic]. At the same time, allegations by Claimants as to failures to disclose material information include 1) no reference to the financial risks inherent in the art gallery business; 2) risk involved in selling only a single artist; 3) financial difficulties of the corporate stores well known to Respondents at the time of the negotiations prior to entering into the Dealer Agreement; 4) certain internal reports showing decline of same store sales, cannibalization and other concerns etc., and 5) concerns raised by PBF regarding the SG Program.

Many issues arose between the parties subsequent to the entering into of the Dealer Agreement and in many instances the nature of the dispute was made known by Claimants to Media Arts. These issues have been well documented in the extensive briefing in this matter. By way of example only, the allegations include, but are not limited to, the so-called Tuesday Morning sale at which Thomas Kinkade's art was advertised and sold at substantial discounts thereby, according to Claimants, seriously eroding the perceived value of the art from which Claimants allege they never recovered. Claimants and many other SG Dealers complained bitterly to Media Arts about this action. The Claimants changed their status from the SG Program to a lower status dealer and brought in other artists to sell but closed both galleries in 2003.

The Panel has had to review extensive testimony over 29 days of Hearings as well as a myriad of supplemental documents introduced by both parties. The Hearings focused to a great extent around 1) what in fact was disclosed to the Claimants at TKU and what was not disclosed at TKU or prior to the entering into of the Dealer Agreement (signed by the Claimants on March 26, 1999) and 2) issues relating to all aspects of the implementation of that Dealer Agreement after March 26, 1999.

III. Analysis

A. Claims Against Respondent Raasch

Claimants failed to meet their burden of proving any conduct of Raasch that is actionable. All claims against him are therefore dismissed.

B. The Contract Claims (Count Three)

The finding of fraud in the inducement by the Majority (discussed below) as a result of the omission to disclose material information to the Claimants results in the setting aside of the Dealer Agreement and obviates the necessity of dealing in detail with Claimant's allegations of various breaches of contract. Thus, while the opinion, in the view of the Majority, may be limited to the decision relating to the fraud claim rather than any issues upon which the decision is not based, in view of the time devoted to the other issues, the Majority would opine as follows:

BREACH OF GOOD FAITH AND FAIR DEALING: The Majority finds that MA did breach the covenant of good faith and fair dealing. We believe it was reasonable for the Claimants, within the narrow terms and conditions and, accordingly, the limitations of the Dealer Agreement, to assume that Media Arts would not have taken actions such as the Red Tag/Tuesday Morning debacle or Media Arts circumventing the Claimants by contacting the Claimants' customers directly and attempting to sell product to them without compensating Claimants. We do not agree with Messrs Thermopolous [sic] and

Montgomery that the sale of product to Red Tag resulting in the discount sale of product by Tuesday Morning was a financial necessity nor do we believe it was within the reasonable discretion of management vis a vis the SG Dealers. While this heavily discounted sale took place, the Claimants who invested family savings in their facilities, were still purchasing product subject to the rigid limitations on price contained in the Retail Sales Policy imposed by and vigorously enforced by MA.

Notwithstanding these breaches, the Claimants, in our opinion, could not adequately demonstrate any other damages than they had already sustained for fraud in the inducement.

C. The Tort Claims (Counts Two and Seven)

INTENTIONAL INTERFERENCE WITH ADVANTAGEOUS BUSINESS RELATIONSHIP: Again, the Majority finds that Media Arts did interfere with the business relationships of Claimants through communications directly with their customers without advising the Claimants and seeking to sell directly to such customers without any apparent remuneration to the Claimants. However, once again, Claimants could not adequately demonstrate any other damages than they had already sustained for fraud in the inducement.

NEGLIGENT MISREPRESENTATION: Since the Majority has determined that Respondent intentionally

and fraudulently failed to disclose material information which would have been significant to the Claimant's reasonable decision making process, the Majority is of the view that there is no reason to consider this claim.

D. The Fraud Claims (Counts Four, Five and Six)

FRAUD IN INDUCEMENT: The Majority finds based upon clear and convincing evidence that Respondents Media Arts and Barnett, as well as Pebble Beach ("PBF") failed to disclose material information which, if known by the Claimants, would have reasonably caused them to decide not to proceed with their investment as an SG Dealer. It is the view of the Majority that any reasonable potential investor should have had certain additional information which in fact was known to but not provided by Media Arts, Barnett or PBF.

The duty to provide certain material information arose when (1) Media Arts and Barnett made certain positive statements relating to the likelihood of success of the soon to be SG dealer and (2) material changes occurred relating to representations made regarding the financial condition of the corporate stores and the SG Dealers. Barnett and Media Arts intended that these Claimants rely upon the information provided, some of which at the outset was misleading and other information which became inaccurate prior to the Claimants entering into the

Dealer Agreement. The Claimants reasonably relied on the information provided. There is no doubt that Barnett profited personally from his actions as the evidence is replete with commissions and salaries paid to him relating directly to the SG Program, including, but not limited to, his commissions resulting from wholesale purchases by the SG Dealers, including Claimants.

First, Media Arts and Barnett painted an unrealistic and misleading picture of the prospects of success for a dealer. Their portrait of the success of Barnett's Carmel California experience was presented for comparative purposes when in fact there is little similarity between Carmel, a highly visible tourist destination, and most prospects' locations including the Charlottesville location of the Claimants. Moreover, Barnett failed to disclose his own special relationship with Thomas Kinkade pursuant to which Barnett was given lucrative advantages not provided to other SG Dealers such as Claimants (e.g. sale of originals, right to transship, etc). Finally, during the many opportunities in which Barnett and others from Media Arts were making presentations, neither Barnett nor anyone else at TKU talked of the inherent risk involved in becoming an art gallery owner, something which even Media Arts expert in his testimony before the Panel advised was essential as part of any such presentation to prospective dealers.

Further, at TKU, Media Arts and Barnett provided the Claimants with certain financial information relating to the success and very limited

failures of the SG Program. They did so with the intent that prospects would rely on this information. In the intervening period between the November 1998 TKU sessions attended by Claimants and the March 26, 1999 date on which the Dealer Agreement became effective, there were negative changes in the financial returns reported by the corporate stores as well as a number of other SG Dealers who were either no longer profitable or were no longer able to stay in business. Media Arts and Barnett had a duty to inform the prospects, including the Claimants, of these and any other material changes which impacted the very information they intended these prospects to rely upon. There was no evidence that MA or Barnett ever updated any of the information that had been presented at TKU in November 1998 with statistics which became available to Media Arts and Barnett. Although Respondents argued that the financial status of the corporate stores was unrelated to these SG Dealers, it is difficult to understand why disclosure of the increasing failures for stores selling Kinkade product was not relevant to someone considering an investment in the SG Program which would entail selling the same product. Media Arts and Barnett left the Claimants with only earlier provided positively focused material information upon which the Claimants relied (as would any reasonable prospect) in making the decision to invest, when in fact some of these key factors had materially changed and the required disclosure of such material change was not forthcoming. Accordingly, as a result of the omission by Media Arts and Barnett, the

Claimants no longer had accurate material information to allow them to properly assess the risks in making their investment decision.

While it might be argued that there was an obligation upon the Claimants to have done more due diligence, Media Arts and Barnett created a certain religious environment designed to instill a special relationship of trust surrounding the investment. Media Arts through it agents, Thomas Kinkade, Ken Rausch, and Barnett, in particular, held itself out to be acting on a higher plain and that, while certainly no legal partnership was created, terms such as "partner", "trust", "Christian" and "God" and many other direct and also oblique references to a higher calling were made to these Claimants. This trust relationship is further evidenced by the fact that Jeff Spinello, one of the Claimants, used legal counsel for his other business ventures about which the Panel was informed; however, with the amount of trust engendered by Respondent through their various devices, the Claimants saw no reason to use legal counsel prior to entering into the Dealer Agreement with Media Arts. The Claimants trust in Media Arts and Barnett created by this overt religiosity was not unreasonable in view of all the facts presented during the arbitration. The Claimants did not have a duty prior to entering into the Dealer Agreement to go back to Respondents to inquire if there were any changes in any information provided to them. Rather, the onus was on Media Arts and Barnett to make such disclosures, and both failed to do so.

There was discussion by Respondents relating to the statute of limitations with regard to the fraud allegations. The Majority finds that the significant failures of disclosure – that is, the omissions – such as the change in fortune of both the corporate stores and many signature dealers – did not come to light in many instances until the discovery phase of this arbitration. Thus, such omissions allow for delayed discovery by Claimants which is certainly reasonable and tolls any statute of limitations. Accordingly, with regard to the fraud claim, the statute did not expire based on the evidence with regard to the claim for fraud in the inducement.

Furthermore, while PBF and its principals may have been dismissed with prejudice, their actions deserve discussion. PBF and its principals appear to have been, in many instances, pawns of Barnett and their own greed allowed them to "revise" business plans as Barnett would suggest in order to show higher potential profits to prospects such as the Claimants (albeit in this case Ms. Hazlewood believed the numbers to be too optimistic). However, even more egregious in terms of improper behavior, PBF, Underwood and Rodriguez had an obligation to these Claimants with whom they had a direct client relationship to advise their clients of the issues and substantial concerns which they themselves had raised in their January letter to Media Arts (Exhibits 164 and 165). In fact, PBF was working on the business plan for the Claimants in February 1999 which is well after the date of PBF's letter in January

1999 to Media Arts. There is no explanation for the irresponsible actions of Underwood and Rodriguez other than greed. Former Media Arts executive, Patty Wilson, in her deposition advised that Mr. Rodriguez expressed concern that he would have to take the "fall" for what seems to the Majority to be participating in "revisionist" business plan work allegedly foisted on him by Barnett. In fact he is right. The Majority is of the view that he should take the responsibility for his actions and so must Underwood whose denial of any wrongdoing in these matters seems rather hollow.

The fact that the Claimants remained in the SG Program despite various actions by Media Arts which were inconsistent with Media Arts' adherence to the higher standards referred to above in the Majority's view will go to reducing the damages in this matter, but does not go to the basic issue of the failure of Media Arts and Barnett to disclose material information in fraudulently inducing the Claimants to enter into the SG Program.

E. Claims Against Barnett

This issue is addressed above in the discussion of fraud in the inducement.

F. The Antitrust Claim

No evidence was offered of any violation of the antitrust laws of the state of Virginia. This claim was therefore not established.

G. Miscellaneous Claims and Issues

UNJUST ENRICHMENT, PROMISSORY ESTOPPEL AND CONSPIRACY CLAIMS: Since the Majority held that there was a valid claim of fraud in the inducement based on clear and convincing evidence, the Majority did not consider the claims of unjust enrichment or promissory estoppel which would require a lesser proof of only a preponderance of the evidence. Conspiracy is not generally a distinct count. What the Majority did find is that Media Arts and Mr. Barnett acted in concert with others.

TERRY SHEPPARD: One final comment relating to the witness Terry Sheppard. Respondent's Counsel focused an inordinate amount of time on motions, comments, and then again sought to re-open the issue after formal Hearings were completed, all relating to the credibility of Sheppard and his testimony. Respondents refused to accept the Majority's view repeatedly stated that the Panel would give the weight it felt appropriate to Sheppard and his testimony and that the Panel had heard sufficient evidence on the subject and did not intend to succumb to Respondent's efforts to provide cumulative evidence on the subject. Now, for Respondent's benefit, the Majority can state that it gave little if any weight to Sheppard or his testimony. However, the Majority is grateful to Sheppard for his having provided many of the essential documents in this arbitration, which were not provided in discovery by Respondents. These documents have been considered by the Panel for their content and stand apart from

any alleged biases Sheppard may have had in providing them.

H. Damages

Having determined that in fact there was fraud by Media Arts and Barnett in inducing the Claimants to enter into the Dealer Agreement, the issue of damages must now be resolved. While the finding of fraud allows the Majority of the Panel to award Claimants the benefit of what they could reasonably achieve based on the information provided by Media Arts and Barnett, it is necessary as part of this determination to consider the likelihood of these Claimants succeeding in this business during the relevant time frame.

The Claimants' expert focused on the difference between the PBF prepared Business Plan ("Plan") and the actual results and, despite repeated questioning by Respondent's Counsel, was prepared only to repeat that Media Arts was the "one responsible" for the divergence between the projections and the actual results. He presumed that the authors of the Plan considered such factors as competency of management, the site, demographics, etc. and he could only conclude that Media Arts was entirely at fault. He further testified that the alleged economic downturn was not a factor and provided articles on art sales and other data supporting his position.

While the Majority finds some merit in the Claimants' experts arguments, we have determined

that there must be a significant discount from the numbers provided by the Claimants' expert in determining damages for a number of reasons. First, Mrs. Hazlewood made it clear in her testimony that she believed prior to entering into the Dealer Agreement that the projections in the Plan were inflated. Secondly, the Claimants' own expert testified that there was no promise that the numbers in the Plan would be achieved. Moreover, the Plan itself contains clear language stating that the "Business can be impacted by as much as 40 percent if the essential strategies are not fully implemented." Third, while there was considerable controversy over the impact of the alleged economic downturn on Claimants' business, the Majority finds that there was a measurable impact resulting from economic factors as well as the disaster of September 11 on those persons who were the potential buyers of Kinkade art. Fourth, the Majority questions the ability of these Claimants to achieve the projected profit in the art gallery business in Virginia based upon their capabilities and implementation as presented during the Hearings, even if they had been provided with all the necessary information to make a reasonable decision to invest and had then done so. While Respondents for other reasons sought to paint these Claimants and, in particular, Mr. Spinello as an experienced businessman, we believe this is an overstatement of his status. So while these factors should not give any comfort to Media Arts or Barnett who participated in the fraudulent conduct, the Majority will reduce the award by these factors

described above which Claimants' expert left to the Panel to determine.

Accordingly, the Majority awards the Claimants the following amounts:

1. The sum of $860,100 which includes 1) out of pocket expenses of $122,500 provided to the Panel by the Claimants; 2) loss of income which could have been earned by these Claimants under a discounted version of the Plan and 3) the value of the possible sale of the business by the Claimants, albeit for a much reduced value in view of the declining success rate of the SG Program (accordingly, the value of 2) and 3) being determined as $737,600).

2. The Account Receivable Counterclaim by Respondent (the sum of $35,460.61 as of December 5 2005) was taken into account in determining the net damages awarded above to Claimant. Accordingly, the Counterclaim is DENIED.

IV. Fees and Costs

The Interim Award determined that

"The Claimants are the prevailing party and may be entitled to an award of reasonable attorneys' fees, costs, expenses, and/or interest, but only as may be determined by the Panel in accordance with the Commercial Rules of the AAA effective July 1, 2003, any

> agreement relating thereto between the parties, and any applicable law.

Claimants filed a fee application seeking fees, costs and pre-award interest in the amount of $4,899,835.07. That amount was later increased in the Reply papers to $5,025,698.37 and in the hearing on fees to $5,240,661.42. Respondents filed opposition to the fee application.

The Panel allowed certain discovery, including depositions of Claimants and Claimants' counsel and its personnel. The Panel ruled on several discovery issues in the course of that discovery.

A hearing was conducted on July 31, 2006 and August 1, 2006 in which evidence and argument was adduced by both sides on these issues. Testimony was offered by Claimants, Norman Yatooma, Sara Smigels and Kenneth Moscaret (expert). That hearing closed on August 1, 2006, but the hearing was left open but only until Tuesday August 8th to receive certain additional submissions of the parties.

Sanctions Orders. The Panel in some cases and the Majority in others determined that certain conduct of both counsel in this case was inappropriate and warranted sanctions. *See* discussion, *supra.* Counsel argued this issue in the context of the hearing on fees and costs described above. The Panel (or the Majority as applicable) wishes to make it clear that such amounts were factored into the determinations of fees and costs set out below by the Majority.

Attorneys' Fees.

The basis for an award of attorneys' fees in this case is AAA Rule R-43(d)(ii) in that the FAC and the Response and Counterclaim each seek an award of reasonable fees in this proceeding.

The Majority determines that the terms of the Claimants' Engagement Agreement and Modified Agreement with Norman Yatoorna Associates are not determinative in arriving at reasonable fees in this matter; rather the reasonable value of the services rendered in this proceeding is the more relevant measure of the amount of attorneys' fees to which Claimants should be entitled under Rule R-43.

The fee application filed by Claimants requested attorneys' fees in the amount of $2,579,208.73. That sum was later increased to $2,669,016.25 at the hearing. It is based on about 7,000 hours of attorney and law clerk time billed at $425-$475 for attorneys and $125-$150 for law clerks and paralegals.

There are no contemporaneously created time sheets or pre-bills which substantiate that the hours which provide the basis for the request were in fact the hours recorded by attorneys and law clerks at or near the time the work was actually performed. Time sheets were not used by the Yatooma firm lawyers and law clerks; instead time was communicated by e-mail or tape to the office manager who transferred that time to billing statements and then erased the tapes and deleted the e-mails.

While this is a unique method of timekeeping, if it were established as reliable and genuine, under California law, it could provide an evidentiary basis for the application. But there is considerable evidence that such time "entries" are not reliable. First, on April 21, 2005, the fifteenth hearing day, Exhibit 235 was offered by Claimants as part of their proof of damages and attested to as accurate by Ms. Hazlewood (under oath) and Mr. Ejbeh (in a specific representation to the Panel). It reflected that Claimants' *fees and costs* to that point in the proceeding totaled $818,000. When the fee application was submitted, the bills supporting the request for fees claimed that *fees only* (not including costs) as of April 21, 2005, totaled more than $1.5 million. Claimants Counsel's bookkeeper testified that she was the source of the fee and cost number presented in Exhibit 235 based on figures provided to her by Mr. Ejbeh. She is the person who was responsible for entry of time entries for the Yatooma firm.

Additionally, many of the fee entries are obviously unsupportable. Mr. Ejbeh claimed to have worked (and billed) exactly 20 hours for 20 straight calendar days including week-ends *(see* Exhibit, 638) – a feat that the entire Panel believes is not possible if proper time records were being maintained.

Claimants' Counsel also claimed a "flat" rate of $425 for each lawyer hour recorded without regard to that lawyer's customary billing rate for other clients (later increased in 2006 to $475 per hour for all lawyers). Lawyer time included hours billed by junior

associates whose customary hourly rates were less than $200. Counsel claim that their clients "agreed" to those rates (Exhibits 607, 608) because they could not make regular payments and obviously could never afford to pay any substantial fee at all. Ms. Hazlewood denied such an arrangement in her deposition (later retracted in her hearing testimony). The Majority had reservations about the validity of this billing agreement between the Claimants and their counsel.

While the Majority shares certain of the views of the dissent regarding the excesses of Claimant's Counsel in its request for fees, we believe that to deny Claimants' Counsel any fees whatsoever would be arbitrary and demonstrate a sense of strong bias in favor of Respondents. We have come to the number below based upon reasonable time and effort which amount is then reduced further by certain amounts for sanctions imposed during the course of the matter against Claimants' counsel. The Majority had understood that the dissenting Arbitrator was in agreement with the decision of the Panel to reduce the amount requested by Claimants' Counsel for fees by approximately two thirds. (The Majority has dealt with fee and cost aspects relating to Respondents Counsel in the Cost section below).

The Majority must remind the parties that excesses by both counsel continued through much of the Hearings in this matter despite even the issuance of Orders relating to improper conduct including the

following from an Order of the Panel dated March 7, 2005:

> "Finally, the Panel reminds both Counsel of the need to maintain a standard of civility in these proceedings. Statements such as " . . . . is obviously arguing out of both sides of his mouth" and " . . . . does not know what he is talking about. . . ." fall beneath that standard and may very well subject counsel to sanctions."

Despite warnings and Orders, Counsel for both sides acted at certain times beneath standards of conduct which this Panel had the right to expect.

The Majority has determined that a reasonable fee based on the scope of the representation, the extent of the effort, the appropriate hourly rates for counsel and staff and other relevant factors, including the discussion of sanctions, *supra,* all as determined by the Majority, is the sum of Nine Hundred Thousand Dollars ($900,000).

The Majority is of the view that this amount for fees is a maximum figure and any attempt by Claimants' Counsel to seek any additional amounts from Claimants through further legal action should not prevail.

Costs. Numerous cost items are claimed. It is the view of the Majority that the following costs incurred or to be incurred by Claimants should be shifted in their entirety from Claimants to Respondents:

(i) Reimbursement of administrative fees from the AAA in accordance with AAA Rule R-49 in the amount of $13,805.00;

(ii) Neutral Arbitrator compensation and costs in the amount of $110,394.53 in accordance with AAA Rule R-51;

(iii) Claimants' Party Appointed Arbitrators ("CPAA") compensation and costs in the amount of $200,000 pursuant to AAA Rule R-43. It is the position of the Neutral Arbitrator in this matter that, in order to insure that the relief granted in this matter is just and equitable, this portion of the CPAA's fees and costs should be shifted to Respondents. Such shifting of the fees of a party appointed arbitrator is not an uncommon practice in AAA cases. This amount of fees and costs being shifted is under 50% of the total of CPAA's total fees and costs and still requires that Claimants pay the balance of CPAA's fees and costs which in excess of $230,000. Without shifting some portion of the CPAA's fees and costs, Claimants would have to pay almost 50% of the Majority's award of damages as fees and costs to the CPAA. Not only were the intentional fraudulent acts of Respondents considered in this decision to shift some of the CPAA's fees and costs but also 1) the extensive additional time required of the entire Panel and counsel resulting from failures of Respondents' Counsel to meet

> its obligations to the tribunal during the discovery phase of the case which such failures were the subject of a separate Order issued by the Majority during the course of the matter(Order dated. . . .) and 2) on many occasions, the Neutral Arbitrator had to admonish Respondents' counsel for making repetitive motions, seeking to introduce cumulative testimony, and other delaying tactics, all of which added substantially to the fees of all members of the Panel as well as counsel; and.
>
> (iv) Reimbursement of certain witness fees in accordance with AAA Rule R-50 in the amount of $9,347.90.

All other requests for reimbursement of fees and costs are DENIED.

Interest. Claimants claim compound interest from a date in 1999 on the compensatory award of $860,100. There is no legal basis for such an award and no basis for an award of compound interest in any event. The sole basis for an award of interest is Cal. Civil Code § 3287(a) ("every person who is entitled to recover damages certain or capable of being made certain by calculation, and the right to recover is vested upon him on a particular day, is entitled also to recover interest thereon from that day . . . "). Such measure applies to the amount of the Interim Award ($860,100) as of the date of issuance of that award (February 23, 2006) up to the date of this Final Award in the amount of 10 percent simple

interest. Accordingly, Claimants are entitled to this amount of simple interest to be paid by Respondents. The Panel declines to make any discretionary award of interest under Cal. Civ. Code § 3288.

Order on Motion re: Right of Parties to Distribute Award to Third Parties. Respondent moved that the parties be forbidden from releasing any copy of or portion of the Final Award until the correction period passes (AAA Rule R-46). The Panel in its Order of September 9, 2006 agreed that a decision on this motion would be included with the Final Award. This motion is GRANTED.

FINAL AWARD

Claimants KAREN HAZLEWOOD AND JEFF SPINELLO are entitled to an award of compensatory damages in the amount of Eight Hundred Sixty Thousand and One Hundred Dollars ($860,100), together with simple interest of ten percent (10%) on that amount from February 23, 2006 to the date of this Final Award. Claimant's are also awarded the following fees and costs:

- Attorneys' fees and costs in the amount of $900,000.00;
- Witness Fees in the amount of $9,347.90;
- Claimant's Party-Appointed Arbitrator Fees in the amount of $200,000.00;
- Claimant's share of AAA Fees and Neutral Fees in the amount of $124,199.53.

The above amounts are payable by Respondents MEDIA ARTS GROUP INC. and RICHARD BARNETT. The above sums are inclusive of the amounts referenced in the below paragraph.

The administrative fees and expenses of the American Arbitration Association total $20,360.00 and shall be borne entirely by Respondents, and the compensation and expenses of the neutral arbitrator total $220,789.06 and shall be borne entirely by Respondents. Therefore Respondents, as part of the fees and costs set forth above, shall reimburse Claimant the sum of One Hundred Twenty-Four Thousand, One Hundred Ninety-Nine Dollars and Fifty Three Cents ($124,199.53), representing that portion of said fees and expenses in excess of the apportioned costs previously incurred by Claimant.

Order on Motion re: Right of Parties to Distribute Award to Third Parties. Respondent moved that the parties be forbidden from releasing any copy of or portion of the Final Award until the correction period passes (AAA Rule R-46). The Panel is [sic] its Order of September 9, 2006 agreed that a decision on this motion would be included with the Final Award. This motion is GRANTED.

The parties and their counsel are ordered to comply with AAA Rule R-46 and therefore may not disclose or release any copy of or portion of the final award until the correction period prescribed by that rule passes.

This Award is in full settlement of all claims and counterclaims submitted to this Arbitration. All claims not expressly granted herein are hereby DENIED.

Date	Mayer Morganroth, Esq.
10/4/06	/s/ James H. Grossman
Date	James H. Grossman

Arbitrator Richard Chernick does not join in this decision ; (*see* Separate Dissent)

AMERICAN ARBITRATION ASSOCIATION
Commercial Arbitration Panel
No. 74 114 01360 03 SUBR

Karen Hazlewood, Jeff Spinello,

Claimants and Respondents by Counterclaim,

and

Media Arts Group, Inc., a Delaware corporation; Lightpost Publishing, Inc.; Thomas Kinkade; Christopher Hunt; Steve Campbell; Karen Foss; Mike Hopper; Richard F. Barnett; Ron B. Ford; Kenneth E. Raasch; Richard E. Stearns; Eric H. Halvorson; Herbert D. Montgomery; Anthony D. Thomopoulos; Moe Grzelakowski; C. Joseph Labonte; Donald Potter; Raymond A. Peterson; Steven Paszkiewicz; Marcie Lowe; Todd Bales; Ashley Taylor,

Respondents and Counterclaimants.

CONCURRENCE IN MAJORITY FINAL AWARD AND RESPONSE TO DISSENT OF RICHARD CHERNICK AND INCORPORATION OF CONCURRENCE IN MAJORITY INTERIM AWARD

(Filed Dec. 15, 2006)

I previously executed the Interim Award and issued a concurrence in said Interim Award, and said concurrence is attached hereto and incorporated in this concurrence to the Final Award which I am able to sign for all reasons, and further disagree with the dissent to the Final Award point by point for the following reasons:

I. INTRODUCTION

1. The Award does not ignore the provisions of the agreement to arbitrate, and in fact, the Award flows from the Respondents' fraudulent inducement causing Complainants to enter into all provisions of the agreement which was adhesive as well. To enforce such an agreement would be inequitable, unconscionable and defies justice.

2. The Respondents were in no way denied a hearing to crucial claims, and this issue was addressed in my concurrence to the Majority Interim Award. This issue was also previously addressed in Mr. Chernick's previous dissent.

3. This issue was previously addressed in the Interim Majority's Award and Mr. Chernick's dissent.

4. The damages awarded were not speculative and again, Mr. Chernick is again addressing an issue raised in his previous dissent. This is improper and cumulative.

5. ***Fees and Costs***: This is an issue decided in the Final Award, and there is no doubt that Claimants are the prevailing party. The Majority found, by clear and convincing evidence, that Respondents had intentionally fraudulently induced Claimants to enter into the subject matter agreement, and in so doing, need not have addressed nor found liability on the other claims such as negligent misrepresentation, unjust enrichment, and so forth. These alternative claims merely required a preponderance of evidence. For example, no one could contend that a Defendant found guilty of murder in the first degree was not guilty because no finding was made on second degree murder, voluntary manslaughter, or involuntary manslaughter.

II. AWARD WAS NOT IN EXCESS OF THE TRIBUNAL'S JURISDICTION

The Award was not made in excess of the Tribunal's jurisdiction, and again, the dissenter is addressing issues in the Interim Award, and again, Mr. Chernick would like to reward the fraudulent inducer. The dissenter repeatedly addresses previous Interim Award issues and certainly understands that all provisions of the adhesive agreement were entered

into as a result of Respondents' fraudulent inducement.

III. DENIAL OF A HEARING

This issue was addressed by the dissent of Mr. Chernick to the Interim Award and addressed by my Concurrence at that time. Mr. Chernick is merely attempting to raise the same issues again, so he can continually have the last word, and so that he can do everything in his power to reenforce his allegiance to his party-appointer, who [sic] he has never found any issue against in these prolonged and cumulative proceedings.

It is entirely true that the Majority has ruled against the Claimants on many of said rulings and did so by dismissing many of the Respondent parties, dismissing claims, finding much less damages than requested, sanctioning Claimants, and so forth; and of course, Mr. Chernick has voted with the Majority on each and every occasion. However, on every occasion the Majority found against the Respondents, Mr. Chernick has, on each and every occasion, dissented.

IV. REFUSAL TO CONSIDER EVIDENCE OF STATUTE OF LIMITATION

Again, this issue is merely repetitive and cumulative.

V. AWARD OF DAMAGES WITHOUT ANY EVIDENCE OF NON-SPECULATIVE, PROXIMATELY CAUSED INJURY

The dissent continues to address issues which were previously addressed and was [sic] part of the Interim Award. There is no reason to repeatedly address Interim Award issues, which only add to the already overwhelming cost and expenses of this arbitration.

VI. FEES AND COSTS

A. Fees

Dissent herein has finally addressed final award issues. The Claimants are undoubtedly the prevailing party. Again, the other counts were mostly ones which were alternative claims or included claims. The burden of proof of clear and convincing intentional fraud in the inducement having been found, then certainly alternative theories which have a lesser burden of proof and which would have only needed to be determined if the intentional fraud had not been proven, were not necessary to be found any more than second degree murder, voluntary manslaughter or involuntary manslaughter need be found when there is a finding of first degree murder.

1. Prevailing party has been previously addressed.

2. **Admissible Evidence**

The fees were presented by appropriate evidence, and the finding of the Majority took all relevant evidence into consideration. The fees were predicated not merely on the reasonableness of the attorney fees as presented, but also on what the Majority determined to be reasonable.

It is remarkable that the dissenter believes that errors in billing wherein the Majority awarded a fraction of the provable fees is unconscionable, yet he has nothing but excuses and avoidance for the Respondents' intentional fraud to people who invested and lost their life savings and borrowed to the hilt as a result thereof.

B. Costs

The dissenter finds no authority that does not permit assessment of a cost award, and in fact, agrees that administrative fees, witness expenses, and neutral arbitrator fees are permitted as well as AAA fees, but does not agree that the non-neutral party appointed arbitrator's fees should be shifted. This despite the fact that Respondents themselves requested costs in their pleadings, as well as fees, and despite the fact that the Arbitrators are to render an award that is consistent with equity and justice. In this matter, the Claimants would be required to expend a great deal of money to pay its party-appointed

arbitrator as a result of the Respondents' fraudulent conduct, exhaustive defense, and refusal to recompense Claimants for the costs and painful losses sustained.

Furthermore, the Rules and Procedures for Commercial Arbitration effective September 15, 2005, provide as follows:

(1) R-43 in addition to a final award, the arbitrator may make other decisions which assess and apportion the fees and expenses, and compensation related to such an award as the arbitrator determines is appropriate.

(2) R-50 provides that expenses of witnesses and all other expenses of the arbitrator, AAA representatives, and any witness may be assessed against any specified parties. The award of fees and all the awarded costs were within the jurisdiction of the arbitrators and were more than reasonable in all respects.

(3) R-51 relates only to the neutral arbitrator's expense.

And in further response to the dissent, as to the non-neutral arbitration fees and costs, the following is stated:

I notice the dissenter non-neutral did not indicate what his fees were, most likely because they are comparable to mine. He also neglected to say that I, as a non-neutral arbitrator, had to travel two (2) days for each hearing session. I also charged my regular

hourly rate, and have practiced nearly 52 years, and am an attorney of national prominence, and have had extensive experience with offices in New York and Detroit.

It is also true that Claimants ran out of money after paying over $200,000 in fees to me; however, the proceedings were prolonged and obstructed by Respondents' wrongful behavior.

My summary of fees contained the hours and the payments made and was proffered in response to the Respondents' inquiry regarding payments made and the balance owed. Mr. Chernick and the Respondents refused to deliver the billings of Mr. Chernick when requested, and this non-neutral arbitrator submitted his summary for all to see, and also a complete billing record was submitted to the Chair for referral purposes.

The comparison made by Mr. Chernick of my fees to Mr. Grossman's is misleading since Mr. Grossman lives in San Francisco, and did not have to travel two (2) days for each hearing, and did not have to live in a hotel, and pay for food for over a month.

It is unfortunate that Mr. Chernick can see nothing that is not to the benefit of the Respondents, and he continually defends and advocates for them.

I therefore concur in the Majority Final Award.

/s/ Mayer Morganroth
MAYER MORGANROTH

Dated: October 4, 2006

AMERICAN ARBITRATION ASSOCIATION
Commercial Arbitration Panel
No. 74 114 01360 03 SUBR

KAREN HAZLEWOOD, JEFF SPINELLO,

Claimants and
Respondents by Counterclaim,

and

MEDIA ARTS GROUP, INC.; a Delaware corporation; LIGHTPOST PUBLISHING, INC.; THOMAS KINKADE; CHRISTOPHER HUNT; STEVE CAMPBELL; KAREN FOSS; MIKE HOPPER; RICHARD F. BARNETT; RON B. FORD; KENNETH E. RAASCH; RICHARD E. STEARNS; ERIC H. HALVORSON; HERBERT D. MONTGOMERY; ANTHONY D. THOMOPOULOS; MOE GRZELAKOWSKI; C. JOSEPH LABONTE; DONALD POTTER; RAYMOND A. PETERSON; STEVEN PASZKIEWICZ; MARCIE LOWE; TODD BALES; ASHLEY TAYLOR,

Respondents and Counterclaimants.

DISSENT OF RICHARD CHERNICK TO FINAL AWARD

(Filed Dec. 15, 2006)

I. Introduction

I am unable to sign the Final Award for five principal reasons:

1. The Award ignores key provisions of the parties' agreement to arbitrate establishing conditions precedent to arbitration, defining what is an arbitrable dispute and defining permissible damages; those provisions preclude any finding of liability or an award of damages. The award is, therefore, in excess of this Tribunal's jurisdiction as defined by these explicit provisions of the agreement to arbitrate.

2. Respondents were denied a hearing as to crucial claims which were proposed to be added for the first time after discovery had concluded and after the evidentiary hearing had commenced. While the Tribunal formally denied Claimants' request to file a Second Amended Claim (Final Award at p. 3) it nevertheless allowed the evidence to be presented in the hearing and then based its principal factual findings of fraud largely upon that evidence. Respondents were unable to discover the basis for these claims and were prevented from offering material evidence rebutting that evidence. When Respondents later discovered (in a related proceeding) material evidence on these issues, they were twice denied the right to reopen the hearing for the presentation of that evidence to this Panel.

3. The Majority largely ignored and misapplied principles of applicable statutes of limitations; much of what Claimants rely on for their fraud claim was known to them at or shortly after their execution of the Dealer Agreements; their filing of a Demand for Arbitration in late 2003 was well after the running of the three-year statute of limitations for fraud.

4. The Majority awarded Claimants damage without any evidence of non-speculative proximately caused injury to Claimants.

5. *Fees and Costs*: The Majority's conclusion that Claimants are entitled to an award of reasonable attorneys' fees as the prevailing party is erroneous for two separate reasons – (a) The determination that Claimants are the prevailing party is highly questionable in, view of the dismissal of all but two Respondents and all but one claim (which claim was not even part of the operative pleading, *see* Point 2, above), and (b) the determination of the amount of reasonable fees is unsupported by admissible evidence. Moreover, the award of compensation for Claimants' Party Appointed Arbitrator is erroneous both because this Panel has no authority to make such an award and because Respondents were denied a hearing as to the basis for such an award by denying them any discovery as to the nature and amount of those fees and expenses, the actual payment by Claimants of such fees and expenses and the existence of any agreement for the payment of such fees and expenses.

Each of these issues is developed more fully below.

II. Award in Excess of the Tribunal's Jurisdiction.

Claimants and Respondent Media Arts Group, Inc. ("Media Arts") entered into several Dealer Agreements

for the distribution of paintings and other products featuring the art work of Thomas Kinkade. The Signature Gallery Dealer Agreements are dated March 26, 1999 (Ex. 445) (Charlottesville) and September 18/20 2000 (Ex. 446) (Fredericksburg). Each contained an arbitration clause.[1] Claimants opened their first Signature Gallery in May of 1999 and closed their Signature Galleries in March and November, 2003. Claimants commenced this proceeding on September 26, 2003.

The arbitration clause (identical in both Signature Gallery Dealer Agreements) provides:

> THE PARTIES AGREE THAT ALL DISPUTES BETWEEN THEM SHALL FIRST BE SUBMITTED TO THEIR CHIEF EXECUTIVE OFFICERS, OR IF NO CHIEF EXECUTIVE OFFICER, TO THE OWNERS. ANY REMAINING DISPUTE SHALL BE SUBMITTED TO A PANEL OF THREE (3) ARBITRATORS WITH EACH PARTY CHOOSING ONE (1) PANEL MEMBER, AND THE THIRD PANEL MEMBER BEING CHOSEN BY THE FIRST TWO (2) PANEL MEMBERS. THE PROCEEDINGS SHALL BE CONDUCTED IN ACCORDANCE WITH THE COMMERCIAL RULES OF THE AMERICAN ARBITRATION ASSOCIATION.

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[1] The parties also entered into Showcase Agreements at later dates; these agreements do not provide the basis for the award of damages to Claimants and therefore need not be addressed in this Dissent.

> THE AWARD OF THE ARBITRATORS SHALL INCLUDE A WRITTEN EXPLANATION OF THEIR DECISION. *THIS ARBITRATION PROCEEDING WILL BE BINDING UPON THE PARTIES.*

See Ex. 445, Standard Terms and Conditions, ¶ 22 (emphasis in original).

The term "Disputes," as used in the arbitration provision, is defined in ¶ 20, entitled "*Period in Which to Submit Disputes*":

> Notice of all disputes shall be submitted to the other party within one (1) year from the date facts occur which create the basis for such dispute. Failure to provide notice of any dispute within such time shall result in a waiver of the right to submit any disputes relying upon such facts."

A. <u>The Dispute Notification Process Defines what is an Arbitrable Dispute; Failure to Give Notice of a Particular Dispute Makes such Dispute Inarbitrable.</u>

The arbitration clause authorizes arbitration only of "disputes." Disputes are those matters remaining after notice of dispute is given pursuant to ¶ 20 and there is no informal resolution of that dispute by negotiation between the chief executive officers or owners (as the case may be) of Media Arts and the subject Dealer (¶ 22).

Notice of dispute provisions are enforceable. *See, e.g., Celt Foods, Inc. v. Hartford Insurance Co.*, 163 Cal. App. 3d 1055, 1064 (1984); *Hening v. Teradyne, Inc.*, 256 F. Supp. 2d 1118, 1126 (S.D. Cal. 2002 (merger agreement; one year); *CBS Broadcasting, Inc. v. Fireman's Fund Ins. Co.*, 70 Cal. App. 4th 1075, 1084 (1999) (insurance contract; one year).

There was no notice by Claimants of any [sic] the disputes which provided the basis for their Demand for Arbitration prior to the commencement of this proceeding in September, 2003 with the exception of the oral objection to the Tuesday Morning sale (given telephonically by Spinello to his District Sales Manager). The Majority found that there were no proximately caused damages from that event. Final Award at p. 8.

As to the claims that were advanced for the first time in the hearing, the breach of the Dispute Notification Process is manifest. As discussed below in Section III, the parties created a process which assured advance notification of claims and the right to discover facts related to such claims prior to the hearing. The tactic used by Claimants (and permitted by the Majority) vitiated that protection and guaranteed no timely notice.

An arbitrator exceeds his powers by making an award that fails to comply with the terms of the arbitration agreement. *Western Employers Insurance Co. v. Jeffries & Co.*, 958 F.2d 258, 262 (9th Cir. 1992) (failure to provide findings of fact and conclusions of

law; it was immaterial that such findings and conclusions would not have changed the outcome of the arbitration); *Bonshire v. Thompson*, 52 Cal. App. 4th 809, 811 (1997) (integration clause provided that terms of agreement may not be contradicted by evidence of any prior agreement and intrinsic evidence may not be admitted in any arbitration; the arbitrator exceeded his power by making an award based on a contract term that extrinsic evidence established was omitted from the agreement).

The Majority's failure here to have even considered the notice of dispute provision, and its failure to have barred claims of disputes as to which the parties' arbitration agreement was not complied with, constitutes an award in excess of the Tribunal's power.

B. Alternatively, the Dispute Notification Process is a Condition Precedent to Arbitration; Claimants' Failure to have given Contractual Notice of the Claims to be Adjudicated by the Tribunal Precludes Consideration of such Claims.

The parties created an express contractual conditions precedent to arbitration. *See* ¶¶ 20, 22, quoted above – notification of a dispute and an attempt at informal resolution prior to submission of the dispute to arbitration. The parties apparently waived step two (informal resolution), but the notice of claim

requirement remains a condition precedent to arbitration.[2]

Courts routinely enforce such conditions precedent and bar arbitration unless and until prescribed pre-arbitration steps have been complied with. *See HIM Portland, LLC v. DeVito Builders, Inc.*, 317 F.3d 41 (1st Cir. 2003) (court refused to compel arbitration until condition precedent (mediation) was met); *Kemiron Atlantic, Inc. v. Aguachem International, Inc.*, 290 F.3d 1287, 1291 (11th Cir. 2002) (*accord*).

The Majority would assert that the dispute notification provisions of the Dealer Agreement are obviated by a finding of fraud in the inducement which, the Majority asserts, "results in the setting aside of the Dealer Agreement . . . " Final Award at 7. This issue is addressed more fully below, but assuming, *arguendo*, fraud in the making of the Dealer Agreement, the arbitration agreement remains unaffected by that determination. *Prima Paint Corp. v. Flood & Conklin Mfg.*, 388 U.S. 395 (1967) (severability of the parties' agreement and the agreement to arbitrate contained within that agreement); *Ericksen, Arbuthnot, McCarthy, Kearney & Walsh v. 1000 Oak Street*, 35 Cal. 2d 312, 323 (1983) (*accord*).

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[2] There is no contention by either party here that the pre-arbitration informal resolution process was not complied with.

C. The Parties' Agreement Defines Permissible Remedies and Liabilities; the Tribunal is Bound by that Agreement and May Not Award Damages that are Expressly Barred by it.

The Dealer Agreement specifies remedies and liabilities that may be awarded in any arbitration between the parties. The Standard Terms and Conditions of the Dealer Agreement at ¶ 13 is entitled "Remedies and Liabilities" and in subparagraph (d) provides that

> IN NO EVENT SHALL EITHER PARTY BE LIABLE HEREUNDER FOR ANY INDIRECT, INCIDENTAL OR CONSEQUENTIAL DAMAGES (INCLUDING LOST BUSINESS PROFITS) SUSTAINED BY THE OTHER PARTY OR ANY OTHER INDIVIDUAL OR ENTITY FOR ANY MATTER ARISING OUT OF, ABOUT, OR PERTAINING TO THE SUBJECT MATTER OF THIS AGREEMENT.

See Ex. 445, Standard Terms and Conditions, ¶ 13(d).

Just as the term "dispute" as used in the arbitration agreement is defined in the notification of dispute provisions (¶ 20), the remedies which may be awarded as to a dispute are defined in ¶ 13(d). The Tribunal has no authority to grant a remedy which the parties' agreement expressly precludes. *O'Flaherty v. Belgum*, 115 Cal. App. 4th 1044 (2004).

All of the damages awarded by the Majority, with the exception of the $122,500 sum (*see* Ex. 235)

identified by the Majority as "out of pocket expenses provided to the Panel by Claimants"), are entirely consequential damages or lost profits – "Loss of income which could have been earned by these Claimants under a discounted version of the Pebble Beach prepared (business) plan and the value of a possible sale of the business by Claimants . . . " Final Award at p. 12.

The offset proven by Respondents in the amount of $35,460.61 should be credited to Respondents against the $122,000; the Majority found the offset to have been established and took it into account in calculating a net award to Claimants. *Id.*

Claimants argue that Media Arts committed fraud in connection with their execution of the Dealer Agreements. Such fraud makes the agreements voidable but not void. There is a well-established distinction in California law between a fraud that causes a contracting party to sign the agreements where he would not have done so if he had been fully informed (voidable) and a fraud in which the contracting party's signature is procured by a misrepresentation as to the agreement itself (such as a false representation that the contracting party may cancel the agreement for a period of 72 hours where the agreement in fact does not permit cancellation). This latter variant of fraud makes the agreement void because there never was mutual assent. *See* B.E. Witkin, *Summary of California Law* (9th ed.), *Contracts*, § 403 *et seq*.

Because the Dealer Agreement here is voidable based on Claimants' assertion of fraud (and the Majority's findings to that effect), Claimants may elect between the alternate remedies of rescission or damages. They have not sought rescission and could not for many reasons (they are in default under the agreements, they have not offered to restore the consideration given to them, etc., etc.[3]). They have thus elected damages and have sought to prove restitutionary damages (recoupment of the $122,500 spent on their Signature Galleries[4]) and lost profits.

Claimants' proof of fraud does not vitiate the Remedies section of the Dealer Agreement (quoted above) which does not permit an award of lost profit or consequential damages because their fraud claim is not germane to the Remedies provision of the Dealer Agreements. In other words, Claimants do not contend they were not fully informed about the limitations of [sic] Remedies section of the Dealer Agreements and they may not avoid the effect of those provisions merely by proving that certain facts about the soundness of their investment were misrepresented or concealed.

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[3] It is not necessary to address the many valid defenses established as to any rescission because Claimants have not sought that remedy. *See* B. E. Witkin, *supra*, *Contracts*, § 877 *et seq*.

[4] This is actually a measure of damages available in the event of a rescission and is not a fraud measure of damages. *Id.*, § 877 *et seq*.

III. Denial of a Hearing.

Background. Claimants filed their Claim in Arbitration on September 26, 2003. Respondents filed their Answer to Claim and Counterclaim on November 18, 2003. Claimants' First Amended Claim ("FAC") was filed on January 2, 2004. Respondents filed a motion to dismiss the FAC. The Panel denied the Motion to Dismiss except that it ordered 16 individual Respondents dismissed (all but Messrs. Campbell, Barnett, Hunt and Raasch). Order dated April 27, 2004. (A further Order on the Motion to Dismiss was issued on July 20, 2004; it did not change the substance of the earlier order.)

At the commencement of the evidentiary hearings on December 15, 2004, Claimants sought to reinstate Thomas Kinkade as a Respondent and to assert additional claims. The Panel directed Claimants to file a motion for leave to file a Second Amended Claim and a proposed Second Amended Claim pleading those additional claims and naming Kinkade as a Respondent. On April 18, 2005, after briefing and argument by counsel, the Panel denied Claimants' motion for leave to file the Second Amended Claim, without prejudice. However, throughout the hearing the Panel overruled numerous objections by Respondents to evidence offered in the hearing by Claimants and supporting those rejected claims.

After the close of the evidence (July 21, 2005), the parties filed written argument. Claimants' briefs

relied heavily on claims contained in the rejected Second Amended Claim. In final argument conducted on December 5, 2005, Claimants renewed their motion to add Mr. Kinkade as a Respondent and to permit the filing of the proposed Second Amended Claim (in the form of an oral "motion to amend to conform to proof"), Respondents strongly objected to the consideration by the Tribunal of such evidence based on the previously denied motion for leave to file that pleading and based on the unfairness of that pleading being permitted without any opportunity to conduct discovery on those claims or to develop opposing evidence.

No formal ruling on this issue was made until issuance of the Interim Award. As a result, and because Respondents feared that the claims contained in the Second Amended Claim would be considered by the Panel, Respondents sought on two separate occasions to reopen the evidence to offer evidence rebutting the facts adduced in the hearing and supporting the claims contained in the Second Amended Claim. The requests to reopen were each denied by the Majority.

Thus, while the Tribunal ruled that the operative pleading is the FAC, the Majority relies almost exclusively for its finding of fraud upon evidence that was not pleaded and as to which Respondents were never able to conduct discovery. These matters might in the usual arbitration be unremarkable, but in this proceeding the parties agreed upon advance notification of claims (§ II above) and an ambitious discovery

program directed to pleaded claims including numerous depositions coordinated with about one dozen other similar cases involving the same counsel and some of the same parties.

The parties and the Panel also consistently treated the pleadings as determinative of the Tribunal's power. For example, the motions to dismiss resolved some claims and were intended to define what was and what was not in dispute in this proceeding[5]; also, the claims for attorneys' fees by both sides contained in their pleadings provides the only basis for the Tribunal to award such fees (*see* Final Award at 13). Finally, Claimants sought sanctions against Respondents for abuses of the discovery process. The Panel sought to enforce the parties' discovery rights, and the Majority granted Claimants' motion (Final Award at pp. 3-4).

The Majority should have treated the issue of the proposed Second Amended Claim in the same fashion. Instead, it relied on evidence that was not the subject of the Claims Notification Process; not disclosed by a pleading that was permitted to be filed in this case; and that was never tested by discovery. Respondents

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[5] Respondents also filed a motion for Summary Adjudication and later filed a Revised Motion for Summary Adjudication. The motion was opposed by Claimants. After hearing, the Panel granted the motion to dismiss all claims based on the Virginia Retail Franchising Act (FAC, Count One) and denied Claimants' motion to add a claim under the California Franchise Investment Act. Order dated December 10, 2004.

were unable to offer opposing evidence during the hearing and were not permitted to reopen to offer such evidence when it was later discovered after the close of the hearing.

The parties to an arbitration are entitled to select the process they prefer and to expect the arbitrators to respect and enforce those choices. In this case they agreed upon a process that required advance notification of claims, pleadings that described claims in detail and the right to conduct discovery to facilitate the development of opposing evidence. *See, e.g.*, *Bonshire, supra*, *O'Flaherty, supra*. The Tribunal did not effectuate the parties' agreed process as to the evidence which provides the basis of the award to Claimants.

IV. Refusal to Consider Evidence of Statute of Limitations.

The Majority notes in passing as to several of Claimants' claims that Claimants did not adequately address the statute of limitations defense raised by Respondents. *See, e.g.*, Interim Award at p. 8 (breach of contract); *id.*, (intentional interference with advantageous business relations).[6] More precisely, Respondents established that such claims accrued more than four or three years (respectively) earlier than the filing of the Demand for Arbitration in September,

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[6] These references were removed from the Final Award.

2003 and that Claimants had knowledge of the wrongful conduct at the time of accrual.

The Majority assesses the fraud claim differently, observing that

> "the significant failures of disclosure – that is, the omissions – such as the change in fortunes of both the corporate stores and many signature dealers did not come to light in many instances until the discovery phase of the arbitration. Thus, such omissions allow for delayed discovery by Claimants which is certainly reasonable and tolls any statute of limitations. Accordingly, with regard to the fraud claim, the statute did not expire based on the evidence with regard to the claim of fraud in the inducement."

Final Award at p. 10.

If the only basis for fraud not barred by the statute of limitations is an omission made after TKU and before March 26, 1999 that there was a change in fortunes of the corporate stores and "many" Signature Dealers, that is not material evidence of fraud (particularly in the face of evidence that Claimants did not rely on such matters in making their decision to become Signature Dealers).

Obviously this point goes to the sufficiency of the evidence and constitutes an assertion of legal or factual error which may not be considered by a reviewing court under the California Arbitration Act (*see Moncharsh v. Helly & Blase*, 3 Cal. 4th 1 (1992))

and may or may not be considered by a reviewing court under the Ninth Circuit's interpretation of the Federal Arbitration Act, 9 U.S.C. § 10; *see Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056 (9th Cir. 1991). But it points out the unfairness of the Majority's denial of a hearing as to these "late discovered" facts that were never part of a pleading allowed by the Tribunal and as to which discovery was never permitted. *See* § III, *supra*.

V. Award of Damages Without any Evidence of Non-speculative, Proximately Caused Injury.

It is apparent from the parties' Arbitration Agreement that lost profit damages are not awardable by this Panel (§ II, *supra*). It is therefore unnecessary to address the adequacy of the evidence on which the Majority awards such damages. The Majority itself discredits the baseline economic model on which Claimants' expert based his assessment of lost profits – the Pebble Beach-prepared business plan. Claimants themselves did not take the plan seriously, as the Majority also recognizes, and the expert refused to credit any external event (9-11, the recession, Claimants' business skills or the way they chose to do business) as a possible basis for the actual results achieved – if the Plan was not achieved it must have been due to Media Arts' conduct.

In order to address these deficiencies, the Majority concedes that it must make a "significant discount"

from the PB Plan. It does not disclose how it was able to do that given the expert's unwillingness to suggest any alternate economic model or even any possible adjustment to the PB Plan. In short, there is no evidence on which any lost profits can be determined with any degree of certainty and without abject speculation.

California law prohibits recoveries based on speculative damages. In *Westside Center Associates v. Safeway Stores* 23, 42 Cal. App. 4th 507, 530-531 (1996), the Court of Appeal stated that: "A plaintiff seeking to recover for a future loss must show with reasonable certainty that the loss actually would have accrued. [Citations omitted.] Damages which are remote, contingent, or merely possible cannot serve as a legal basis for recovery" (*quoting California Shoppers, Inc. v. Royal Globe Insurance Co.*, 175 Cal. App. 3d 1, 62 (1985)); *see also S.C. Anderson, Inc. v. Bank of America N.T. & S.A.*, 24 Cal. App. 4th 529, 536 (1994). In *Piscitelli v. Friedenberg*, 87 Cal. App. 4th 953, 989, 990 (2001), the court stated: "Whatever its measure in a given case, it is fundamental that damages which are speculative, remote, imaginary, contingent, or merely possible cannot [sic] served as a legal basis for recovery. [Citations.] [T]he general principle inherent in the recovery of damages for loss of prospective profits is that the evidence must make reasonably certain their nature, occurrence and extent. In sum, such evidence must be of reasonable reliability."

It is no answer to say that Respondents "caused" the injury and therefore Claimants need not meet the usual requirement of presenting reliable evidence. By definition, one does not have the opportunity to consider damage evidence unless one can conclude that a defendant or respondent engaged in wrongful conduct. Indeed, the party that caused the need for speculation about lost profits here is one Claimants willingly dismissed – Pebble Beach and its principals. There is simply no authority which would permit rank speculation to be the sole basis for the calculation of a damage award.

VI. Fees and Costs.

A. Fees.

The Majority's conclusion that Claimants are entitled to an award of reasonable attorneys fees as the prevailing party is erroneous for two separate reasons – (a) The determination that Claimants are the prevailing party is highly questionable in view of the dismissal of all but two Respondents and all but one claim (which claim was not even part of the operative pleading, and (b) the determination of the amount of reasonable fees is unsupported by admissible evidence.

There is no basis for an award of fees on any traditional ground – the existence of a statute or case authority supporting an award of fees or the existence of an agreement authorizing prevailing party attorneys' fees. The sole basis for a fee award is the

happenstance that each side claimed fees in their pleadings filed in this proceeding (FAC of Claimants, Response and Counterclaim of Respondents). AAA Rule R-43(d)(ii) uniquely provides that "if all parties have requested [attorneys'] fees" the award of the Arbitrators may include such an award.

While there is no reference in Rule R-43 (d)(ii) to "prevailing party," the Majority properly adopts that standard in applying that Rule in order to determine entitlement. But Claimants hardly prevailed. Seventeen of 19 Respondents were dismissed (most on motion early in the case because there [sic] were merely listed in the case caption. There were not even charging allegations made against them (including Thomas Kinkade himself). Then all of the claims articulated in the FAC were determined not to be established; only a "fraud in the inducement" claim, part of a proposed Second Amended Claim never permitted by the Panel to be filed, was the sole basis on which the Majority found "damages" (these issues are addressed more fully in Points III and V, above). On what basis can it be said the Claimants prevailed in such circumstances?

The fee application filed by Claimants requested attorneys' fees in the amount of $2,579,208.73. That sum was later increased to $2,669,016.25 at the hearing. It is based on about 7,000 hours of attorney and law clerk time billed at $425-$475 for attorneys and $1.25-$150 for law clerks and paralegals.

There are no contemporaneously created time sheets or pre-bills which substantiate that the hours which provide the basis for the request were in fact the hours recorded by attorneys and law clerks at or near the time the work was actually performed. Time sheets were not used by Yatooma lawyers and law clerks; time was communicated by e-mail or tape to the office manager (Sara Smigels) who transferred that time to billing statements and then erased the tapes and deleted the e-mails.

While this is a unique method of timekeeping, if it were established as reliable and genuine, it could provide an evidentiary basis for the application. But there is considerable evidence that such time "entries" are not reliable. First, on April 21, 2005, the fifteenth hearing day, Ex. 235 was offered by Claimants as part of their proof of damages and attested to as accurate by Ms. Hazlewood (under oath) and Mr. Ejbeh (representation to Panel); it reflected that Claimants' fees and costs to that point in the proceeding totaled $818,000. When the fee application was submitted, the bills supporting the request for fees claimed that fees only (not including costs) as of April 21, 2005, totaled more than $1.5 million. Ms. Smigels testified that she was the source of the fee and cost number presented in Ex. 235; she is the person who was responsible for entry of time entries for the Yatooma firm.

Additionally, many of the fee entries are obviously unsupportable and therefore false. Mr. Ejbeh claimed to have worked (and billed) exactly 20 hours

for 20 straight calendar days including week-ends (*see* Ex. 638) – a feat that is not possible if honest time records were being maintained.

Bills were sent infrequently to Claimants by their counsel; a small fraction were paid ($95,000, including a $10,000 retainer) and it was agreed on March 29, 2005, that no further bills would be sent to them at all. They had little incentive to even review the bills, and their counsel seemingly had little incentive to keep accurate time records.

Claimants' Counsel also claimed a "flat" rate of $425 for each lawyer hour recorded without regard to that lawyer's customary billing rate for other clients (later increased in 2006 to $475 per hour for all lawyers. Lawyer time included hours billed by junior associates whose customary hourly rates were less than $200. Counsel claim that their clients "agreed" to those rates (Ex. 607, 608) because they could not make regular payments and obviously could never afford to pay any substantial fee at all. This is a *non sequitur* of the highest order and a slim reed on which to base blatantly unreasonable hourly rates on top of fabricated hours.

The Majority recognizes these facts (indeed relies on them to reduce the fee claim to $900,000, a small fraction of the total requested by Claimants). But simply estimating a reasonable time and effort and a reasonable rate to arrive at a "reasonable" fee in these circumstances rewards dishonesty and ignores a manifest failure of proof.

The proper remedy when knowingly false support is offered for a claimed reimbursement is to deny the reimbursement entirely rather than to try, as the Majority did, to figure out what was reasonable in the circumstances (*i.e.*, what the Firm would have submitted if it had kept honest records). This sanctions a fraud on the Panel and is wholly inappropriate. I would conclude that there is no basis for any award of fees because there is no reliable evidence of actual hours or actual rates on which to base such an award.

B. Costs.

The Dealer Agreements contain no provision for cost shifting. The only basis on which the Arbitrators have power to shift costs must therefore be found in the AAA Rules. Unlike fees, where there is a specific provision on which we based our determination that the pleadings of the parties constituted an "agreement" to authorize an award of fees (AAA Rule 43(d)(ii)). This section is expressly limited to fees and therefore it cannot be argued that the pleadings can provide a similar basis for allocating costs.

C. Non-neutral Party-Appointed Arbitrator's Fees and Expenses.

The Majority (including the Party Arbitrator who benefits from this determination) relies on AAA Rule R-43 as authority for an award of almost half of the claimed fees and expenses of Claimant's Non-Neutral Party Appointed Arbitrator. That Rule permits the

arbitrator to "assess and apportion fees and expenses and compensation related to such award, as the arbitrator determines is appropriate," but such discretion must be consistent with the parties' agreement. *See Advanced Micro Devices, Inc. v. Intel Corp.*, 9 Cal. 4th 362 (1994), which upheld the award by an arbitrator of a remedy which a court could not have granted but which was consistent with the parties' contract. The Supreme Court in *AMD Intel* relied on the parties' arbitration agreement which granted broad arbitral power in fashioning remedies; such language is not dissimilar from the AAA provision which generally authorizes arbitrators to "grant any remedy or relief that is just and equitable **and within the scope of the parties' agreement**." JAMS Rule 24(c); *see* AAA Commercial Arbitration Rules, Rule 43(a).

The AAA rules governing costs (R-49, R-50 and R-51) generally limit cost awards to AAA administrative expenses (R-49), witness expenses (R-50) and neutral arbitrator compensation (R-51). But there is no basis for an award of non-neutral party-appointed arbitrator compensation under the AAA Rules. Indeed the reference to Neutral Arbitrator Compensation is in the title of Rule 51 and makes the intent of that Rule unmistakable. The parties here having chosen the AAA Commercial Arbitration Rules therefore cannot fairly be said to have contemplated the shifting of non-neutral party-appointed arbitrator compensation. This, under AMD-Intel and Rule R-43, the arbitrators have no discretion to shift such fees. *See O'Flaherty v.*

Belgum, 115 Cal. App. 4th 1044 (2004) (award not authorized by parties' agreement vacated).

There is a more serious issue raised by this aspect of the Final Award. The only evidence of the fees and expenses "incurred" by Claimants is a two-page ledger from the Party Arbitrator's law firm dated May 3, 2006 which tracks charges and payments in this case. Ex. 605. The aggregate charges total $452,300 and the aggregate payments total $253,300.[7] Because Claimants are claiming all such fees as costs in this proceeding, Respondents understandably were interested in seeing underlying records and asked for an opportunity to examine documents supporting the ledger and documents relevant to the relationship between the Party-Appointed Arbitrator and Claimants, including the terms of any engagement agreement between them. They were denied any discovery[8] and therefore had no way of challenging the accuracy of the ledger or probing the circumstances of the relationship between Claimants and their Party-Appointed Arbitrator.[9]

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[7] Smigels Testimony at TR p. 8141 suggests that these charges are "certainly going to be higher . . . pursuant [sic] to the conclusion of the hearing." There are at least $12,000 in additional charges (TR p. 8029 referencing an unpaid balance of $211,000 rather than $199,000.

[8] Dana N. Levitt's letter to James II. Grossman dated May 8, 2006.

[9] All of the billing statements were apparently sent to the neutral Arbitrator but to no one else. TR p. 8030-8031.

One reason such discovery was warranted here is the significant disparity between the aggregate fees and expenses of the Neutral Arbitrator (slightly more than $200,000) and the aggregate fees and expenses of the Party-Appointed Arbitrator (at least $465,000). Another reason discovery was warranted is the failure of Claimants to have paid their Party Arbitrator's billings as incurred. Claimants made it clear throughout this proceeding that they had few resources; the likelihood that they would be able to pay their non-neutral Party Arbitrator only if they were successful in this proceeding suggests that the Party Arbitrator may have had some financial risk in undertaking this assignment. That raises the issue of the need for his disclosure of a possible financial interest in the outcome of this proceeding. *See* Code of Ethics for Arbitrators in Commercial Disputes Canons II, IX, X (accessible on the AAA web page at www.adr.org). This issue was, of course, not explored by Respondents because they were not permitted to pursue it by the Majority (including Claimant's Party-Appointed Arbitrator). *See Aetna Cas. & Sur. Co. v. Grabbert*, 590 A.2d 88, 90 (R.I. 1991) (party-appointed arbitrator charged contingent fee; *vacatur* of award denied because the award was unanimous); Alan Rau, *Integrity in Private Judging*, 38 S. Tex. L. Rev. 485, 497-514.

The Concurring Opinion of Mr. Morganroth does not respond to these ethical and process issues effectively or at all. General statements about his career accomplishments or about his travel time are not a

substitute for detailed and verifiable facts pertaining to his financial relationship to the parties who appointed him. Nor does he address the disclosure issue. (I shall resist the temptation to respond to the *ad hominum* [sic] references to my service in this case. Such comments say more about the author than the recipient.)

For all of the reasons stated above, I am unable to sign the Final Award. The Majority's determination of liability and award of damages are not authorized by the parties' agreement, the Rules of the AAA, or are not permitted by law.

Dated: October 6, 2006.

/s/ Richard Chernick
Richard Chernick
Arbitrator

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

THE THOMAS KINKADE COMPANY, a California corporation fka Media Arts Group, Inc.; RICHARD F. BARNETT, Plaintiffs-Appellees/ Cross-Appellants, v. KAREN HAZELWOOD; JEFF SPINELLO; THOMAS KINKADE AT THE DOWNTOWN MALL LLC, Defendants-Appellants/ Cross-Appellees.	Nos. 07-16421 and 07-17119 D.C. No. CV-06-07034-MHP Northern District of California, San Francisco ORDER (Jul. 24, 2009)

Before: HAWKINS and TALLMAN, Circuit Judges, and SINGLETON,* Senior District Jidge.

The panel has voted to deny the petition for rehearing. Judges Hawkins and Tallman have voted to deny the petition for rehearing en banc. Judge Singleton has recommended denying the en banc petition.

* The Honorable James K. Singleton, Senior United States District Judge for the District of Alaska, sitting by designation.

The full court has been advised of the petition for rehearing en banc and no Judge has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35.

The petition for rehearing and petition for rehearing en banc are DENIED.

STATUTORY PROVISIONS INVOLVED

1. FAA Section 10(a), 9 U.S.C. § 10(a), provides:

(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration –

(1) where the award was procured by corruption, fraud, or undue means;

(2) where there was evident partiality or corruption in the arbitrators, or either of them;

(3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or

(4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

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Selected Provisions of the Government Code

2009 EDITION

As revised by Legislative Enactments
up to and including the
second year of the
2007-2008 Regular Session
and Rules of Court changes
issued by the Judicial Council
through November 24, 2008

§1283.8. Time for Making Award.

The award shall be made within the time fixed therefor by the agreement or, if not so fixed, within such time as the court orders on petition of a party to the arbitration. The parties to the arbitration may extend the time either before or after the expiration thereof. A party to the arbitration waives the objection that an award was not made within the time required unless he gives the arbitrators written notice of his objection prior to the service of a signed copy of the award on him. **Leg.H.** 1961 ch. 461.

Ref.: Cal. Fms Pl. & Pr., Ch. 33, "Contractual Arbitration: Appointment of Arbitrator and Conduct of Proceeding."

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§1668. Exempting Liability for Fraud, Negligence, or Violation of Law.

All contracts which have for their object, directly or indirectly, to exempt any one from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law. **Leg.H.** 1872.

Ref.: Cal. Fms Pl. & Pr., Ch. 295, "Hospitals," Ch. 300, "Indemnity and Contribution," Ch. 308, "Insurance," Ch. 520, "Settlement and Release"; Cal. Class Actions Prac. & Proc., §12.03[2][a], [d]; MB Prac. Guide: Cal. Contract Lit., §§18.01-18.03, 18.06[1][a]; W. Cal. Sum., 1 "Contracts" §§304, 422, 660, 662-666, 671, 672, 675, 2 "Insurance" §§100, 226, 324, 4 "Sales" §94, 5 "Torts" §231, 13 "Equity" §123.

[LOGO] American Arbitration Association
Dispute Resolution Services Worldwide

Commercial Arbitration Rules and Mediation PROCEDURES

(Including Procedures for Large, Complex Commercial Disputes)

Amended and Effective June 1, 2009

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IMPORTANT NOTICE

These rules and any amendment of them shall apply in the form in effect at the time the administrative filing requirements are met for a demand for arbitration or submission agreement received by the AAA. To ensure that you have the most current information, see our Web Site at www.adr.org.

INTRODUCTION

Each year, many millions of business transactions take place. Occasionally, disagreements develop over these business transactions. Many of these disputes are resolved by arbitration, the voluntary submission of a dispute to an impartial person or persons for final and binding determination. Arbitration has proven to be an effective way to resolve these disputes privately, promptly, and economically.

The American Arbitration Association (AAA), a not-for-profit, public service organization, offers a broad range of dispute resolution services to business executives, attorneys, individuals, trade

* * *

the reopened hearing within which to make an award.

R-37. Waiver of Rules

Any party who proceeds with the arbitration after knowledge that any provision or requirement of these rules has not been complied with and who fails to state an objection in writing shall be deemed to have waived the right to object.

R-38. Extensions of Time

The parties may modify any period of time by mutual agreement. The AAA or the arbitrator may for good cause extend any period of time established by these rules, except the time for making the award. The AAA shall notify the parties of any extension.

R-39. Serving of Notice

(a) Any papers, notices, or process necessary or proper for the initiation or continuation of an arbitration under these rules, for any court action in connection therewith, or for the entry of judgment on any award made under these rules may be served on a party by mail addressed to the party, or its representative at the last known address or by personal service, in or outside the state where the arbitration is to be held, provided that reasonable opportunity to be heard with regard to the dispute is or has been granted to the party.

(b) The AAA, the arbitrator and the parties may also use overnight delivery or electronic facsimile transmission (fax), to give the notices required by these rules. Where all parties and the arbitrator agree, notices may be transmitted by electronic mail (E-mail), or other methods of communication.

(c) Unless otherwise instructed by the AAA or by the arbitrator, any documents submitted by any party to the AAA or to the arbitrator shall simultaneously be provided to the other party or parties to the arbitration.

R-40. Majority Decision

When the panel consists of more than one arbitrator, unless required by law or by the arbitration agreement, a majority of the arbitrators must make all decisions.

R-41. Time of Award

The award shall be made promptly by the arbitrator and, unless otherwise agreed by the parties or specified by law, no later than 30 days from the date of closing the hearing, or, if oral hearings have been waived, from the date of the AAA's transmittal of the final statements and proofs to the arbitrator.

R-42. Form of Award

(a) Any award shall be in writing and signed by a majority of the arbitrators. It shall be executed in the manner required by law.

(b) The arbitrator need not render a reasoned award unless the parties request such an award in writing prior to appointment of the arbitrator or unless the arbitrator determines that a reasoned award is appropriate.

R-43. Scope of Award

(a) The arbitrator may grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties, including, but not limited to, specific performance of a contract.

(b) In addition to a final award, the arbitrator may make other decisions, including interim, interlocutory, or partial rulings, orders, and awards. In any interim, interlocutory, or partial award, the arbitrator may assess and apportion the fees, expenses, and compensation related to such award as the arbitrator determines is appropriate.

(c) In the final award, the arbitrator shall assess the fees, expenses, and compensation provided in Sections R-49, R-50, and R-51. The arbitrator may apportion such fees, expenses, and compensation among the parties in such amounts as the arbitrator determines is appropriate.

(d) The award of the arbitrator(s) may include:

(i) interest at such rate and from such date as the arbitrator(s) may deem appropriate; and

(ii) an award of attorneys' fees if all parties have requested such an award or it is authorized by law or their arbitration agreement.

R-44. Award upon Settlement

If the parties settle their dispute during the course of the arbitration and if the parties so request, the arbitrator may set forth the terms of the settlement in a "consent award." A consent award must include an allocation of arbitration costs, including administrative fees and expenses as well as arbitrator fees and expenses.

R-45. Delivery of Award to Parties

Parties shall accept as notice and delivery of the award the placing of the award or a true copy thereof in the mail addressed to the parties or their representatives at the last known addresses, personal or electronic service of the award, or the filing of the award in any other manner that is permitted by law.

R-46. Modification of Award

Within 20 days after the transmittal of an award, any party, upon notice to the other parties, may request the arbitrator, through the AAA, to correct any

clerical, typographical, or computational errors in the award. The arbitrator is not empowered to redetermine the merits of any claim already decided. The other parties shall be given 10 days to respond to the request. The arbitrator shall dispose of the request within 20 days after transmittal by the AAA to the arbitrator of the request and any response thereto.

R-47. Release of Documents for Judicial Proceedings

The AAA shall, upon the written request of a party, furnish to the party, at the party's expense, certified copies of any papers in the AAA's possession that may be required in judicial proceedings relating to the arbitration.

R-48. Applications to Court and Exclusion of Liability

(a) No judicial proceeding by a party relating to the subject matter of the arbitration shall be deemed a waiver of the party's right to arbitrate.

(b) Neither the AAA nor any arbitrator in a proceeding under these rules is a necessary or proper party in judicial proceedings relating to the arbitration.

(c) Parties to an arbitration under these rules shall be deemed to have consented that judgment upon the arbitration award may be entered in any federal or state court having jurisdiction thereof.

(d) Parties to an arbitration under these rules shall be deemed to have consented that neither the AAA nor any arbitrator shall be liable to any party in any action for damages or injunctive relief for any act or omission in connection with any arbitration under these rules.

R-49. Administrative Fees

As a not-for-profit organization, the AAA shall prescribe an initial filing fee and a case service fee to compensate it for the cost of providing administrative services. The fees in effect when the fee or charge is incurred shall be applicable. The filing fee shall be advanced by the party or parties making a claim or counterclaim, subject to final apportionment by the arbitrator in the award. The AAA may, in the event of extreme hardship on the part of any party, defer or reduce the administrative fees.

R-50. Expenses

The expenses of witnesses for either side shall be paid by the party producing such witnesses. All other expenses of the arbitration, including required travel and other expenses of the arbitrator, AAA representatives, and any witness and the cost of any proof produced at the direct request of the arbitrator, shall be borne equally by the parties, unless they agree otherwise or unless the arbitrator in the award assesses such expenses or any part thereof against any specified party or parties.

R-51. Neutral Arbitrator's Compensation

(a) Arbitrators shall be compensated at a rate consistent with the arbitrator's stated rate of compensation.

(b) If there is disagreement concerning the terms of compensation, an appropriate rate shall be established with the arbitrator by the AAA and confirmed to the parties.

(c) Any arrangement for the compensation of a neutral arbitrator shall be made through the AAA and not directly between the parties and the arbitrator.

R-52. Deposits

The AAA may require the parties to deposit in advance of any hearings such sums of money as it deems necessary to cover the expense of the arbitration, including the arbitrator's fee, if any, and shall render an accounting to the parties and return any unexpended balance at the conclusion of the case.

R-53. Interpretation and Application of Rules

The arbitrator shall interpret and apply these rules insofar as they relate to the arbitrator's powers and duties. When there is more than one arbitrator and a difference arises among them concerning the meaning or application of these rules, it shall be decided by a majority vote. If that is not possible, either

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